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AGRICULTURE, RURAL DEVELOPMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 1988

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

H.R. 3520/S. 1800

AN ACT MAKING APPROPRIATIONS FOR AGRICULTURE, RURAL DEVELOPMENT, AND RELATED AGENCIES PROGRAMS FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 1988, AND FOR OTHER PURPOSES

PART 2 (Pages 1–687)

COMMODITY FUTURES TRADING COMMISSION
DEPARTMENT OF AGRICULTURE
FOOD AND DRUG ADMINISTRATION

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AGRICULTURE, RURAL DEVELOPMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 1988

TUESDAY, MARCH 17, 1987

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:02 a.m. in room SD–138, Dirksen Senate Office Building. Hon. Quentin N. Burdick (chairman) presiding.

Present: Senators Burdick, Harkin, Cochran, Kasten, and Grassley.

DEPARTMENT OF AGRICULTURE

FOOD AND NUTRITION SERVICE

STATEMENTS OF:

JOHN BODE, ASSISTANT SECRETARY FOR FOOD AND CONSUMER SERVICES, DEPARTMENT OF AGRICULTURE

ANNA KONDRATAS, ACTING ADMINISTRATOR, FOOD AND NUTRITION SERVICE

ACCOMPANIED BY:

GEORGE A. BRALEY, DEPUTY ADMINISTRATOR, SPECIAL NUTRITION PROGRAMS, FOOD AND NUTRITION SERVICE

G. SCOTT DUNN, ACTING DEPUTY ADMINISTRATOR, FAMILY NUTRITION PROGRAMS

WILLIAM G. BOLING, BUDGET OFFICER, FOOD AND NUTRITION SERVICE

ROBERT E. SHERMAN, BUDGET OFFICER, DEPARTMENT OF AGRICULTURE

SUZANNE HARRIS, DEPUTY ASSISTANT SECRETARY FOR FOOD AND CONSUMER SERVICES

INTRODUCTION OF WITNESSES

Senator BURDICK. Good morning. The subcommittee will come to order.

Today, the subcommittee continues its review of the President's proposed budget for fiscal year 1988. We have asked Assistant Secretary for Food and Consumer Services, John Bode, to represent the Department of Agriculture. Joining him from the Food and Nutrition Service is Acting Administrator, Anna Kondratas, who was appointed to the position just yesterday. We welcome Ms. Kondratas, and also take this time to commend Robert Leard for his able service as Administrator of FNS for several years.

The subcommittee is also pleased to welcome the Human Nutrition Information Service to today's hearing. Dr. Laura Sims, Administrator, will report on recent activities at HNIS. Bob Sherman, who represents the Office of Budget and Program Analysis for the Department, is also with us today. Welcome to you all.

The Food and Nutrition Service and the Human Nutrition Information Service have a major role in agriculture. They distinctively represent that arm of the federal government that protects our consumer interest and provides basic food assistance to poor and vulnerable Americans.

With an estimated budget of $19.3 billion in fiscal year 1988, the Food and Nutrition Service administers the food stamp program, offering 20 million low-income Americans basic food benefits each month. Almost $5 billion of the FNS budget is targeted to children. Child nutrition programs offer balanced lunches or breakfasts at schools, snacks or meals at child care centers, and summer meals at camps and schools to millions of young Americans.

The WIC and commodity supplemental food programs sustain low-income mothers, their infants and children through periods of nutritional risk. Each has had notable, positive results. Special groups are served by the needy family program on Indian reservations, the nutrition program for the elderly at senior centers throughout the country, the temporary emergency food assistance program through emergency feeding organizations in local communities, and the special milk program in private schools.

One of the most remarkable aspects of these programs is that they draw together partnerships between federal, state, and local governments and nonprofit organizations to provide food assistance to the needy.

Under current law, the Food and Nutrition Service fiscal year 1988 budget of $19.3 billion represents an increase of $420 million over the fiscal year 1987 level of $18.9 billion. The administration proposes to cut back $1.1 billion through a number of legislative proposals that we will explore at our hearing today.

The Human Nutrition Information Service has primary responsibility for formulating national dietary guidelines and for nutrition monitoring of our general population. This year, HNIS will commence its decennial national survey, the Nationwide Food Consumption Survey.

In addition, HNIS will continue ongoing activities in nutrition research and monitoring. The fiscal year 1988 budget includes an increase of $1.7 million, bringing the HNIS total fiscal year budget tc $8.7 million under the administration's budget.

It is a pleasure to be here with you today. Your written statements will be put into the record in full, and you may summarize them if you wish. You may proceed in any order you may care to.

We welcome the Senator from Wisconsin. Do you have an opening statement, Senator?

Senator KASTEN. Mr. Chairman, thank you very much. I don't have an opening statement, but I look forward, if I have the chance, to submitting questions for the record. I thank you, Mr. Chairman, and I look forward to the testimony.

STATEMENT OF JOHN BODE

Mr. BODE. Thank you, Mr. Chairman. I was going to make essentially the same points that you made in your very good opening statement, so I will skip by those and I will only add a couple of points.

In addition to the partnerships, the working relationships that we feel these programs build, I think it is good to note that dual objectives are achieved through the commodity programs, of providing assistance to America's farmers at times when market conditions are depressed as well as providing that food to children, especially low-income children.

The other point I wanted to make is that 95 percent of the benefits from the Food and Nutrition Service programs are now directed to families with income below 130 percent of the poverty guidelines. We have these programs much better targeted now than in the past.

That is a trend we would like to continue, and that is why our basic proposals are to direct assistance as effectively as possible to America's low-income people.

With your permission, Mr. Chairman, I will defer to Anna Kondratas to present testimony on behalf of the Food and Nutrition Service.

FNS ACCOMPLISHMENTS

Ms. KONDRATAS. Thank you. Mr. Chairman, I will avail myself of your kind permission to summarize my statement and submit the full statement for the record.

Thank you very much for the opportunity to present the fiscal year 1988 budget for the Food and Nutrition Service. Our agency has about 1,900 employees. Working with state and local governments, it administers the school lunch and breakfast programs, the food stamp program, the WIC program, and the various commodity-based programs. During the past year, FNS has placed great emphasis on initiatives to improve program management, to increase the quality of service to recipients and to improve program accountability to help assure the targeting of benefits to the needy.

Enhanced communication and cooperation between federal, state, and local governments has improved the efficiency and the effectiveness of our programs. I would like to highlight some of these shared initiatives.

In the WIC program, we have been working cooperatively with the National Association of WIC Directors for the past year and a half on an initiative called "Focus on Management."

In the food stamp program, FNS is working with state and local agencies to ensure that benefits are delivered promptly and correctly to applicants. State agency reviews have targeted such areas as timely completion of applications, program accessibility, hearing procedures and notifications.

In the important area of commodities, we have been working with the American School Food Service Association and other USDA agencies to bring about improvements in all aspects of the commodity procurement and distribution system. One area being addressed is an up-to-date computerized inventory system.

Not only are we responding to customers' concerns, but we are developing a better communications network so that state and school food service personnel will have the latest information on commodities.

The Department has also undertaken initiatives to increase the use of surplus commodities in nutrition assistance programs. These initiatives have strengthened the links between the Department's farm price support and stabilization activities and its food assistance efforts for low-income households.

1988 BUDGET REQUEST

In the FNS budget for 1988, we are requesting the funding necessary to carry out the administration's policies under current law, a total of $19.3 billion.

The Food and Nutrition Service is also preparing legislative proposals which would, if enacted, save $1.1 billion and reduce the total budget authority required to $18.2 billion. We expect these legislative proposals to be submitted shortly.

Late last year Congress enacted a series of legislative amendments requiring payments not planned in the 1987 budget. These amendments are being implemented now and among other things they require additional payments for breakfasts served under the child nutrition programs, reopening the programs to schools with higher tuitions, and opening the special milk program to split session kindergartens in schools with other food service programs.

Child nutrition appropriations made by the committee for 1987 are estimated to be sufficient to cover the changes. However, a supplemental appropriation of $3.4 million is requested for the special milk program in 1987. Supplemental requests also pending for the agency include pay costs of $713,000, and retirement cost contributions of $1.5 million.

For the child nutrition programs, the Food and Nutrition Service is requesting $4,475,226,000. This current law request anticipates growth of nearly 1.5 percent in the number of school meals and a 3.7-percent increase in reimbursement rates for school meals.

For the special milk program, the fiscal year 1988 current law request is $34 million. A total of $1,687,541,000 is requested for the supplemental nutrition assistance program for women, infants, and children, or WIC. This is an increase of $24 million above the funds available from the fiscal year 1987 appropriation. It is expected that this will fund participation of about 3.3 million individuals.

In the commodity supplemental food program, we are requesting $34.6 million. Given historical trends, it is possible that actual participation will be lower in fiscal 1987 than expected. To the extent that the caseload is unused in 1987, funds will remain available for use in fiscal year 1988 to support an additional caseload.

For the food stamp program under current law we are requesting nearly $12 billion. This request assumes a continued drop in unemployment to 6.5 percent, 19.3 million participants and an average benefit per person which rises from $45.75 in 1987 to $47.66.

For Puerto Rico, we are again proposing a separate grant of $825 million. Under the appropriation, cash and commodities for selected groups, we are seeking a slight reduction from the 1987 appropriation. This includes a reduction of $3.5 million in the food distribution program on Indian reservations. However, due to stable participation and lower food costs, no change in participation or benefits is planned.

The nutrition program for the elderly will be increased by the amount of inflation, $3.1 million. No funds are requested for the state administration of the temporary emergency food assistance program for fiscal year 1988.

We have strived to serve the important missions assigned to FNS while reducing staff by 27 percent and travel expenses by one-third over the last 5 years. We are requesting for the expenses of the Food and Nutrition Service a total of $87,942,000 of which $6,942,000 is required by law for the pay increase and increased retirement costs.

We are offsetting these increases by a further reduction of 90 ceiling staff-years below that authorized in the current year. The agency will again rely on attrition to make these changes.

In the budget request before you is the second year of our 5-year information resources management plan. This plan would redesign and streamline the 60 different systems now in operation. The overall request is for $8 million, including $2.8 million for administrative systems. These levels are critical if we are to continue to improve program monitoring and administration with fewer personnel.

This is a brief overview of the agency's request, Mr. Chairman. We will be pleased to respond to your questions. Thank you.

Mr. BODE. Mr. Chairman, if you like, Dr. Laura Sims could proceed with the HNIS testimony, and then we could respond to all questions, if that is your preference.

Senator BURDICK. Very fine.

Senator KASTEN. Mr. Chairman, could I just, first of all, ask unanimous consent that I could submit some questions having to do with the special milk program to the witnesses?

I am not going to be able to be here for the conclusion of the hearing, but I do have some specific questions on special milk, and then I will be back in touch with you and your people after you have had a chance to reply to these questions.

Thank you, Mr. Chairman.

PREPARED STATEMENTS

Senator BURDICK. There are no objections; it is so ordered. The questions will appear in the record at the end of today's hearing. We will insert the complete statements of Mr. Bode and Ms. Kondratas at this point in the record and proceed with testimony from the Human Nutrition Information Service.

[The statements follow:]

STATEMENT OF JOHN BODE

I am pleased to have this opportunity to speak to you today on the 1988 Budgets for the Food and Nutrition Service and the Human Nutrition Information Service.

With me today are Ms. S. Anna Kondratas, Acting Administrator of the Food and Nutrition Service, and Dr. Laura Sims, Administrator of the Human Nutrition Information Service. Ms. Kondratas was appointed to her position March 16, 1987.

Mr. Chairman, as you know, our mission is to ensure that food assistance is available to all citizens who cannot provide for themselves. Presently, about 95 percent of the program dollars are spent on those families with income below 130 percent of the poverty index. We continue to advocate and support changes in the basic legislation to raise the 95 percent to nearly 100 percent. Effective delivery of program services and improved accountability continue to be our goals.

Our programs are largely "means-tested," with the income and financial situation of the recipient being the primary criterion for eligibility. By their very nature, these programs are very sensitive to the conditions of the economy. This budget reflects lower unemployment and inflation.

This budget presentation also reflects the costs of these programs under current law. Legislative proposals projected to save over $1 billion in Fiscal Year 1988 alone are being reviewed now for submission to Congress.

The work of the Human Nutrition Information Service is also important because it enables the Secretary to monitor the effects of our agricultural economy on the nutritional well-being of the Nation and to take steps to see that research-based information on nutrition is conveyed to the public in a meaningful and responsible manner.

Dr. Sims and Ms. Kondratas will provide more details on the budget and our legislative proposals. We will be glad to answer any questions the Committee might have.

STATEMENT OF S. ANNA KONDRATAS

Thank you for the opportunity to present the Fiscal Year 1988 Budget for the Food and Nutrition Service.

Our Agency has about 1900 employees who, working with States and local governments, administer the School Lunch and Breakfast Programs, the Food Stamp Program, the WIC Program and the various commodity based programs for Indians, elderly and pregnant women and their children at nutritional risk.

Improved Communications and Service

During the past year, FNS has placed great emphasis on initiatives to improve program management, thereby increasing the quality of service to recipients. In addition, improving program accountability helps ensure the targeting of benefits to the needy while helping to reduce unnecessary expenditures both at the Federal and State levels. Enhanced communication and cooperation between Federal, State and local governments has improved the efficiency and effectiveness of our programs and has been extremely beneficial in reducing program error and abuse.

I would like to highlight some of the initiatives we have undertaken with State and local governments to improve both the accountability and quality of services that are provided to eligible recipients.

In the WIC Program, we have been working cooperatively with the National Association of WIC Directors for the past year and a half on an initiative called Focus on Management. This national effort focuses on four major areas -- vendor management, administrative costs, caseload management and nutrition services. In partnership with the States, we have developed a set of performance standards for each of these areas. Each State then conducted an assessment of WIC operations against these standards to use as a framework for program improvements.

In the Food Stamp Program, FNS has, through its Operation Awareness effort, helped provide States with the tools they need to improve program efficiency and effectiveness. Our current emphasis is on local level initiatives. Through Operation Awareness we provide States with analyses of specific problems on request, assist in the exchange of information between States, provide technical assistance, and get State officials together in regular meetings to discuss problems and successes.

In addition, FNS is working with State and local agencies to ensure that benefits are delivered promptly and correctly to applicants. State agency reviews have targeted such areas as timely completion of applications, program accessibility, hearing procedures and notifications. Current reviews cover residency requirements, timeliness and expedited service.

In the important area of commodities, we have been working with the American School Food Service Association and other USDA agencies to bring about improvements in all aspects of the commodity procurement and distribution system. The areas being addressed include an up-to-date computer system for tracking and accounting for foods. This new system, when operational, will enable us to expand the variety of foods we offer as well as provide up-to-the-minute information on orders.

Not only are we responding to customers' concerns, but we are developing a better communication network so that State and school food service personnel will have available to them the latest information on commodities. We will soon begin mailing a quarterly newsletter to every State distributing agency and school district participating in the National School Lunch Program. Not only do we desire to keep our customers informed about the latest information, but we want to improve the image of the commodity program by letting them know that USDA has a quality food distribution system that reflects and supports the high quality of American agriculture.

The Department has also undertaken initiatives to increase the use of surplus commodities in nutrition assistance programs. These initiatives have strengthened the linkages between the Department's farm price support and stabilization activities and its food assistance efforts for low-income households.

IMPROVE PROGRAM INTEGRITY

For some years now, the Agency has launched various initiatives to combat fraud, waste, and abuse. These efforts continue to be important as they help strengthen public perception and support of food assistance programs. Some of the initiatives in the child nutrition area include:

- Implementation of statutory requirements for computer matching.
- Implementation of provisions requiring local authorities to verify a sample of school lunch and breakfast applications.
- Implementation of the Assessment, Improvement and Monitoring (AIMS) System for the School Lunch and Breakfast Programs, which established performance standards for program operations.

Since 1981, a variety of performance indicators show marked improvements in the Food Stamp Program as well:

- Payment error rates have declined; issuance loss rates have been cut; fraud investigations, hearings, and disqualifications have all increased; and the value of claims established and collected for improperly issued benefits has increased.
- The overpayment error rate fell from 9.9 percent in 1981 to 8.3 percent (estimated) in 1985, a 16 percent decline and the ATP and mail issuance loss rates are about 70 percent lower than in 1981.

1988 BUDGET REQUEST

At the Committee's request, the FNS Budget for 1988 is consistent with the presentation of the rest of Agriculture. We are requesting the amounts necessary to carry out the Administration's policies under current law. These amounts total $19.3 billion. The Food and Nutrition Service is also preparing legislative proposals which, if enacted, will save $1.1 billion and reduce the total Budget Authority required to $18.2 billion. We expect these legislative proposals to be submitted shortly.

Supplementals for 1987

Late last year Congress enacted a series of legislative amendments requiring payments not planned in the 1987 budget. These amendments are being implemented now and, among other things they require additional payments for breakfasts served under the Child Nutrition Programs, reopening the programs to schools with higher tuitions, and opening the Special Milk Program to split session kindergartens in schools with other food service programs.

Child Nutrition Appropriations made by the committee for 1987 are estimated to be sufficient to cover the changes; however, a supplemental appropriation of $3.4 million is requested for the Special Milk Program in 1987. Supplemental requests also pending for the Agency include pay costs of $713,000 and retirement cost contributions of $1,503,000.

Child Nutrition Programs

For the Child Nutrition Programs, the Food and Nutrition Service is requesting $4,475 million. This current law request anticipates growth of nearly 1.5 percent in the number of school meals and a 3.7 percent increase in reimbursement rates for school meals.

Legislation is being proposed to reduce budget authority by $826 million by:

- Eliminating cash and commodity subsidies for meals served to non-needy children. ($555 million)

- o Reducing special payments to the school lunch and breakfast programs. ($22.7 million)
- o Reinstating the means test in the Family Day Care Program and eliminating payments for the non-needy. ($194 million)
- o Making the summer program rates comparable to other programs. ($22.2 million)
- o Eliminating Federal funding for the Nutrition Education and Training Program. ($5 million)
- o Eliminating special funding for child care audits. ($8.7 million)
- o Reducing State administrative funding formula from 1 1/2 to 1 percent. ($18.1 million)

For Fiscal Year 1988 only, we are proposing that the Budget Authority required for State administrative expenses be reduced by the considerable carryover funds that have built up in the States. As has been the practice since Fiscal Year 1981, some of the funds requested in this budget will be used to pay claims for some of the meals served in September of 1987. The current rollover estimate for this year is about $167 million.

Special Milk Program

For the Special Milk Program, the Fiscal Year 1988 current law request is $34 million. Legislation is being proposed, that would take effect July 1, 1987, to limit reimbursement to milk served only to children from households with incomes below 130 percent of poverty. If the requested 1987 supplemental is provided and the proposed legislation takes effect on July 1, sufficient funds will be available from Fiscal Year 1987 to provide the estimated $2.2 million needed to fund free milk served to needy children during 1988. Therefore, no new Budget Authority would be required under our legislative proposal.

WIC/CSFP Programs

A total of $1,687.5 million is requested for the Supplemental Nutrition Assistance Program for Women, Infants and Children (WIC). This is an increase of $24 million above the funds available from the Fiscal Year 1987 appropriation. It is expected that this will fund participation of about 3.3 million individuals.

In the Commodity Supplemental Food Program we are requesting $34.6 million --a decrease of $6.9 million from 1987. For Fiscal Year 1987, funds are allocated to support a caseload of 159,000 women, infants and children as well as 72,000 elderly. Given historical trends it is possible that actual participation will be lower. To the extent that this caseload is unused in 1987, funds will remain available for use in Fiscal Year 1988 to support additional caseload. A legislative proposal reducing administrative contributions for bonus commodities from 15 percent to 5 percent is being prepared for early submission. Absent carryover, the budget proposal of $34.6 million will serve about 182,000 eligible participants.

Food Stamp Program

For the Food Stamp Program under current law we are requesting nearly $12 billion ($11,962,550,000). This request assumes a continued drop in unemployment (to 6.5 percent), a reduction of 146,000 in average monthly participation to 19.3 million participants and an average benefit per person which rises from $45.75 in 1987 to $47.66 in the budget year. It also assumes the collection of $233 million from States for excess errors under existing law. We anticipate that the collection process will move faster than it has in the past after the resolution of outstanding legal and technical issues. Legislation is being drafted which will reduce these costs by $278 million including:

- $269 million by tying error-rate liability to the cost of over-issuances rather than administrative funding and establishing prospective error-rate liability. These billings will be adjusted when the actual reports are complete.

- A reduction of $5 million in State administrative cost sharing by reducing the amount payable to States with high costs and begin phasing out special higher Federal share for ADP costs and anti-fraud activities.
- Changing the law on the treatment of energy costs and job training and partnership income to provide greater equity. ($67 million)

The savings resulting from the proposed Food Stamp Program changes will be partially offset by an increase of $63 million due to proposed changes to the Aid to Families with Dependent Children (AFDC) Program.

For Puerto Rico, we are again proposing a separate grant of $825 million, the level established in 1981. This is a reduction from the authorized level of $852.8 million in 1987 where it was part of the larger food stamp appropriation. A fixed funding level is appropriate for this program because the Commonwealth has the freedom to control costs by designing its own program and specifying eligibility and benefit levels.

Other Commodity Programs

Under the appropriation "Cash and Commodities for Selected Groups", we are seeking a slight reduction from the 1987 Appropriation. This includes a reduction of $3.5 million in the Food Distribution Program on Indian Reservations. Due to stable participation and lower food costs, no change in participation or benefits is planned. The Nutrition Program for the Elderly will be increased by the amount of inflation, $3.1 million. Legislation will be proposed to convert this program to a fixed grant. No savings are proposed for this legislative change which we feel will improve administration and enable providers to better plan their programs.

No funds are requested for the Temporary Emergency Food Assistance Program for Fiscal Year 1988. In accordance with recent Congressional action, funds for 1987 that were proposed for deferral in the Budget have been made available to States. The program total of $50 million was released on February 13.

EFFECTIVE ADMINISTRATION

We have strived to serve the important missions assigned to FNS while reducing staff by 27 percent and travel expenses by one-third over the last five years.

Vital to the effective delivery of these programs are the funds for the expenses of the Food and Nutrition Service. As indicated earlier, we have made significant reductions in our overall costs. Fiscal Year 1988 is no exception. We are requesting a total of $87,942,000 of which $6,942,000 is required by law for the pay increase and increased retirement costs.

We are offsetting these increases by a further reduction of 90 ceiling staff years below that authorized in the current year. The agency will again rely on attrition to make these changes.

In the budget request before you is the second year of our five-year Information Resources Management Plan. This plan, will redesign and streamline the sixty different systems that the Food and Nutrition Service (FNS) currently has for its program operations. The overall request is for $8 million including $2.8 million for administrative systems. These levels are critical if we are to continue to improve program monitoring and administration with fewer personnel.

While funding for Federal administrative costs have declined, the Federal share of State administrative costs has increased. Payment of these amounts are, for the most part, required by law. But as the administering Agency, we are emphasizing the need for effectively managing these grants, coordinating these efforts with the Department of Health and Human Services and attempting to improve State Agency financial monitoring. In this budget, we are requesting a realistic limit of 90 days on the timeframe for filing food stamp State administrative cost claims following the end of the fiscal year.

This is a brief overview of the Agency's request Mr. Chairman. We will be pleased to respond to your questions.

HUMAN NUTRITION INFORMATION SERVICE

STATEMENT OF LAURA S. SIMS, ADMINISTRATOR

PROPOSED BUDGET

Dr. SIMS. Thank you, Mr. Chairman and members of the committee. I am pleased to tell you about our program at HNIS and the way we intend to spend the $8.7 million appropriation which we have proposed for fiscal year 1988.

We are continuing most activities in fiscal year 1988 at levels about equal to that which was spent in fiscal year 1987. Our applied research supports USDA's commitment and responsibilities to monitoring the dietary status of the population and to providing a sound dietary guidance to the American public.

Within USDA, we are responsible for the national nutrition monitoring system as well as for the dietary guidelines for Americans. Both efforts are sponsored jointly with DHHS. We are the national repository for information on the nutritive value of food. We conduct national surveys to get information on food consumption by household and by individuals.

We assess diets for their nutritional quality, and we are continuing to conduct some research to find more effective ways to present this dietary and nutritional information to the public.

The increase which we have proposed is mainly for reinstating a continuing survey of food intakes, similar to those conducted in 1985 and 1986. The survey was discontinued this year, in 1987, when our larger decennial survey, the nationwide food consumption survey, was underway.

Continuous monitoring to provide dietary data has been a longtime objective of the Department. It was part of the implementation plan for the national nutrition monitoring system, which was sent to Congress in 1981, and with which we continue to work.

The continuous monitoring proposed within the 1988 budget will be achieved through a cost-effective, moving average approach, which will provide annual data on food and nutrient intakes by the general population as well as a special sample of the low-income population.

PREPARED STATEMENT

Thank you for the opportunity to make our remarks, and I will be pleased to answer any questions the committee may have.

[The statement follows:]

STATEMENT OF LAURA S. SIMS

I am Dr. Laura Sims, Administrator of the Human Nutrition Information Service (HNIS). I am pleased to be here today to discuss HNIS's budget request for Fiscal Year 1988.

Mission of the Human Nutrition Information Service

The mission of the Agency is threefold: (1) to conduct and interpret applied research on the nutrient content of foods and the nutrient content of U.S. food supplies; (2) to monitor the patterns of food consumption by Americans and the nutritional adequacy of their diets; and (3) to provide information needed by the American public to make informed food choices. This research supports the Department's commitment and responsibilities to monitoring the dietary status of the population and to nutrition education. The importance of research in these areas is specifically emphasized by the Congress in the Food and Agriculture Act of 1977, the Agriculture and Food Act of 1981, and the Food Security Act of 1985.

HNIS has a total of about 95 scientists and support staff in two operating units: the Nutrition Monitoring Division and the Nutrition Education Division. The Nutrition Monitoring Division is the national resource for information on the nutritive value of foods and conducts national surveys to obtain information on food consumption by households and individuals. The Nutrition Education Division analyzes diets for implications for nutrition education programs and conducts research to determine how guidance can best be communicated. Within the USDA, HNIS has responsibility for the National Nutrition Monitoring System (NNMS)--a system of activities, primarily in USDA and the Department of Health and Human Services (DHHS), that are essential to providing timely information about the dietary and nutritional status of Americans and factors that affect that status. HNIS also coordinates the development and publication of the Dietary Guidelines for Americans--another USDA/DHHS joint effort.

Major accomplishments in the past year illustrate our Agency's commitment to its mission:

1. The Continuing Survey of Food Intakes by Individuals (CSFII), which was initiated in 1985, was continued in 1986. This national survey provides up-to-date information on the food and nutrient consumption by women of childbearing age and by young children in the general population and in a sample of low-income households. Usefulness of the survey data to policymakers, researchers, and educators, as well as the food industry, has been enhanced by the Agency's ability to provide the results in an unprecedented short period. The first report from each survey year was published within 6 or 7 months following the completion of data collection. To date, three reports from the 1985 survey and one from the 1986 survey have been published. The remaining five reports are nearing completion. Results from the two years of CSFII data collection and comparisons with data from the 1977-78 Nationwide Food Consumption Survey demonstrate that major changes in food consumption practices may occur in the years between the USDA decennial surveys and that annual data collections can provide timely indications of these changes.

   At the completion of the 1985 Continuing Survey, HNIS initiated several extramural studies to identify dietary problems and the factors that have a beneficial or detrimental effect on diets. Factors being studied are income, education, employment, size and location of the household, food assistance program participation, and eating practices such as eating away from home, skipping meals, and snacking. Information from such studies is important in the development of the Agency's nutrition education materials and in the design of effective programs and policies related to agriculture, food assistance, and education.

2. The Nationwide Food Consumption Survey 1987 (NFCS 1987) was planned in 1986 and data collection will start April 1, 1987. NFCS 1987 is the comprehensive, decennial survey of food consumption. It contains a national sample of 6,000 U.S. households and an additional sample of 3,600 low-income households. Information on food use and costs of the entire household and food actually eaten by each household member will be obtained. The last such survey was conducted in 1977-78. NFCS 1987 is more comprehensive than the CSFII 1985 and 1986 in that it includes information on food eaten by individuals in all sex-age groups, not just women and young children. The NFCS 1987 will also include information on food use and food costs by households, information not collected in the CSFII. These additional data are essential components in the NNMS and provide data for special studies of the economies of food consumption, household food management and food sufficiency, and the dietary status of individuals by sex and age. The data are also needed for the development and costing of the USDA family food plans at different levels. The least costly of the food plans--the thrifty food plan--is the standard for benefit levels in the Food Stamp Program.

3. The first report of the USDA-DHHS Joint Nutrition Monitoring Evaluation Committee, delivered to Congress in July 1986, involved major effort from HNIS staff, and most particularly the Director of the Nutrition Education Division who served as Executive Secretary to the Committee. This first report on the nutritional health and dietary status of the U.S. population summarizes results of the Committee's integration and interpretation of information from

parts of the NNMS, particularly USDA's NFCS and DHHS's National Health and Nutrition Examination Survey.

4. As directed by the House Subcommittee on Rural Development, Agriculture and Related Agencies, HNIS has attempted to formulate a Federal dietary guidance policy and monitor its use. After release of the second edition of "Dietary Guidelines for Americans" in September 1985 by USDA and DHHS, the Secretaries of the two Departments adopted the Guidelines as the basis for nutrition education efforts. HNIS coordinated, under the auspices of USDA's Committee on Research and Education, the formation of an interagency Dietary Guidelines Working Group. This group is working effectively to help USDA and other Federal departments speak with one voice in dietary guidance matters. The Executive Secretary of this group is from HNIS.

   Since the bulletin presenting the second edition of the Dietary Guidelines for Americans was released in September 1985, the Department has printed and distributed almost 2 million copies. Many more copies have been printed by other groups from copies for reproduction provided by the Department. The Department is providing the bulletin free in both English and Spanish through the Consumer Information Center in Pueblo, Colorado. HNIS featured the Dietary Guidelines through USDA/FDA Regional Journalists' Conferences and through special exhibits at conferences of professionals in food, nutrition, and health fields.

5. To help the public put the Dietary Guidelines into practice, HNIS developed and published seven short bulletins--one pertaining to each of the guidelines. These bulletins draw on information from HNIS research on food composition, food consumption behavior, food selection, and food preparation. They incorporate communication

concepts found to be most appropriate for national education efforts through Agency research.

6. HNIS continues to expand the National Nutrient Data Bank to cover more foods and nutrients and to develop data bases for special uses. Two additional sections of Agriculture Handbook No. 8, "Composition of Foods," were published in 1986. These two sections--on Beef Products and Beverages--are part of HNIS's ongoing 23-section revision of the Handbook. The new section on Legumes and Legume Products is at the printers, and the section on Finfish and Shellfish Products is in final stages of preparation.

7. The nutrient data base developed for use with the 1985 and the 1986 CSFII and its revised version for use with the 1987 NFCS includes 28 food components compared with the 14 used in the 1977-78 NFCS. This data base for surveys is updated at frequent intervals and is made available on public-use data tapes for use by researchers, hospitals, and others. HNIS provided the data bases for assessing diets reported in DHHS's Hispanic Health and Nutrition Examination Survey (HHANES) and will provide updated data bases for use in the forthcoming NHANES III.

Fiscal Year 1988 Budget Request

The HNIS budget request for Fiscal Year 1988 is for $8.7 million, up from our Fiscal Year 1987 appropriation of $7.0 million. Most of this increase will be used to reinstate the Continuing Survey of Food Intakes by Individuals (CSFII) in 1989 in a modified form.

CSFII 1985 and 1986 demonstrated that monitoring population groups in the years between the large decennial surveys can provide timely notice of changes in foods eaten by individuals and in their dietary status. Continuous monitoring of the dietary status of the general population and of low-income Americans has been called for by the Congress. This budget increase will provide such monitoring using a cost-effective "moving average" approach recommended by two committees established by the Food and Nutrition Board of the National Academy of Sciences. The 1989 CSFII is designed to cover more population groups at a lower cost than the 1985 and 1986 CSFII by using a 2-to-5-year moving average for all sex-age groups. Annual estimates of dietary status for both men and women 19-50 years will be provided after 2 years, while estimates for other sex-age groups will be provided after 3, 4, or 5 years. The new CSFII will consist of two samples--an all-income sample of individuals in 1,500 households and a low-income sample of individuals in 750 households. Low-income households are defined as those with incomes of 130 percent of poverty or less.

The funding requested for HNIS for Fiscal Year 1988 will support continued analysis of data collected in NFCS 1987; completion of the analysis of CSFII 1986; some testing of methods for CSFII 1989; support of the Joint Nutrition Monitoring Evaluation Committee; and current program levels for the National Nutrient Data Bank activities and nutrition education research.

Ongoing HNIS Activities

Nutrition Monitoring. The Joint Implementation Plan for the National Nutrition Monitoring System (NNMS) was submitted to Congress in 1981. This plan included carefully planned sequential and systematic monitoring efforts that have been implemented by HNIS: the Continuing Survey initiated in 1985, the comprehensive NFCS in 1987, and the expansion of the National Nutrient Data Bank. An extension of the 1981 Joint Implementation Plan to describe NNMS activities into the 1990's is being developed.

Major monitoring activities in progress include:

- o Data collection for the NFCS 1987 will start on April 1, 1987 and continue for a year.

  As in the last NFCS in 1977-78, NFCS 1987 includes information on (1) household food use and food costs for a 1-week period and (2) the food actually consumed by individual household members during a 3-day period. Socioeconomic information such as income, education, employment, and participation in food assistance programs is obtained. Also, individuals are asked to evaluate their health status and household food managers are asked to assess the sufficiency of their food.

  NFCS 1987 will differ from NFCS 1977-78 in that the interview process for the household component of the survey will be computerized. Also, based on results from methodological studies conducted since 1977, some new procedures have been incorporated to improve data collection procedures and overall efficiency in providing food consumption information. A total of 19 reports are planned for the NFCS 1987; the first two, covering the first quarter of data collected, will be released late this year or early in 1988. Indepth analytical studies to be conducted extramurally are being planned.

- o Planning for the modified CSFII 1989, including details and testing for computerizing the food intake interview.

- o Data collection for CSFII 1986; analysis and reporting of results from CSFII 1985 and 1986.

- o Updating of the support systems for NFCS 1987, CSFII 1989-96, and NHANES III 1988-94. These systems include food coding, volume/

weight conversions, nutrient content of foods, and other complex data files for processing and interpreting data from dietary surveys.

- Continued coordination with DHHS to assure that the monitoring activities of the two Departments meet the needs of Congress and others for information on the dietary and nutritional status of the population, yet are as compatible as possible given the different goals and data needs of programs of the two Departments.

- Annual estimates of the nutrient content of the national food supply. This series provides annual data on the U.S. food supply since 1909.

- Assistance for State public health nutritionists and other State and local leaders in the use of USDA nutrition monitoring data through participation in regional workshops and other means.

National Nutrient Data Bank. The National Nutrient Data Bank, an essential component of the National Nutrition Monitoring System, is utilized in assessing the nutritional quality of diets reported in USDA and DHHS surveys. Also, the data bank is a valuable national resource for researchers and educators concerned with food and nutrition, as well as for planners of national and international food and nutrition programs. To date, 14 revised sections of Agriculture Handbook No. 8 have been released. Release of sections on three additional food groups--legumes, fish, and fast foods--is planned for this year.

Nutrition Education. The Agency develops food and nutrition materials and techniques for increasing nutrition knowledge of professionals and consumers and improving food selection behavior. Of particular importance is research to solve practical food selection dilemmas faced by Government policymakers, educators, health professionals, and consumers.

Major nutrition education research activities underway include:

- Promotion of the "Dietary Guidelines for Americans," second edition, including the Spanish version. These guidelines form the basis of dietary guidance policy in USDA and DHHS, and HNIS attempts to monitor Federal publications for conformance to guideline concepts.

- Interpretation of the Dietary Guidelines to help the public. HNIS develops and publishes information to help the public put the Guidelines into practice: Seven short bulletins--one for each of the seven guidelines--were published last year. Another seven, in preparation, tell how to use the guidelines while shopping for food, planning meals, preparing food at home, making quick meals, preparing bag lunches, selecting food away from home, and choosing snacks.

- Development of a microcomputer system for assessing the nutritional adequacy of diets. This system is primarily for use by Extension Agents. HNIS has developed the software and the data bases and is working with Extension in testing the system.

- Estimation of costs for food plans at four cost levels monthly. (The least costly of these food plans, the Thrifty Food Plan, is the legal basis for Food Stamp Program benefits.) Data from NFCS 1987 will be used to revise the food content and the costing procedures for the four food plans.

- Analysis of data from the surveys to gain an understanding of dietary problems and their causes. For example, researchers are studying changes in eating patterns such as increased proportions of away-from-home meals and snacking and their effects on diet quality.

In summary, HNIS is the national resource for information on the nutrient content of individual foods and of the food supply and on the food and nutrient content of the diets of households and individuals. The Agency conducts research needed for the development of materials and techniques required for helping Americans to improve their diets. We view these activities as basic to the Department's mission to assure that a safe, nutritious, wholesome supply of food is available to all Americans and to provide information with which healthy Americans can select nutritious and healthful diets.

Mr. Chairman, I will be happy to answer any questions you or other Committee members may have.

BIOGRAPHICAL SKETCH

LAURA S. SIMS, PH.D.

Since September 1986, Dr. Sims has served as the Administrator of the Human Nutrition Information Service at the U.S. Department of Agriculture (USDA). Prior to joining USDA, she was at Penn State University where she had been a member of the faculty for the past ten years. At Penn State, she was Professor of Nutrition in Public Health and Senior Research Associate in the Institute of Policy Research and Evaluation.

Her major research interests include study of the psychosocial influences on food consumption behavior, effectiveness of public nutrition information strategies and delivery systems, and issues dealing with community nutrition program delivery, evaluation, and policy. She has received a number of honors and awards including being a member of the founding class of W.K. Kellogg Foundation National Fellows, named Outstanding Alumna of 1983 by the Department of Food Science and Human Nutrition at the Michigan State University, and recipient of the Duffy-Mott Award for Outstanding Doctoral Dissertation in Human Ecology. She is professionally active in several organizations and currently serves as Editor for the Journal of Nutrition Education and is a member of the Council on Research, The American Dietetic Association. She is also a Registered Dietitian.

In addition to authoring over 50 research publications and heading various research projects at Penn State, Dr. Sims recently served as principal investigator for the project, "National Assessment of Extension's Food and Nutrition Programs," and was a member of the research team investigating "Technology Transfer in the Food and

Agricultural Sciences" under contract with USDA. Prior to assuming her current position, she was active on several national governmental advisory boards and task forces, notably as a member of USDA's Human Nutrition Board of Scientific Counselors and as a member of the LSRO/FASEB Review Panel for the 1990 National Nutrition Objectives.

Dr. Sims holds a Ph.D. in Nutrition from Michigan State University, an M.P.H. (Master of Public Health) in Nutrition, with specialization in Maternal and Child Health, from the University of Michigan, and a B.S. in Nutrition and Family Studies from The Pennsylvania State University. Dr. Sims is married to a Penn State professor; the couple has three children.

INTRODUCTION OF ASSOCIATE

Mr. BODE. Senator, I failed at the outset to introduce Dr. Suzanne Harris, on my right, she is the Deputy Assistant Secretary for Food and Consumer Services, and I asked her to join us so that we might be able to respond more fully to your questions.

CNP STATE ADMINISTRATIVE EXPENSES

Senator BURDICK. The fiscal year 1987 Appropriations Act made available $4.23 billion for child nutrition programs, including $775 million to be made available for the extension of an official budget request submitted to Congress.

Why is $20.4 million in the state administrative expenses unobligated in fiscal year 1987?

Mr. BRALEY. Mr. Chairman, that money was made available to the states, but not used.

Senator BURDICK. Do you mean to say there is no request for it?

Mr. BRALEY. That money has not been used; it has been carried over, Mr. Chairman.

Senator BURDICK. What I am trying to figure out, if I may, is why it is carried over? Is there no demand for it from the states?

Mr. BODE. That is correct, Mr. Chairman.

Senator BURDICK. Why were there unobligated state administrative expenses for the fiscal year 1986?

Mr. BRALEY. We had a similar proposal on that last year, Mr. Chairman. Mr. Boling, our budget officer, may be able to respond a little bit more in depth on that.

Mr. BOLING. The law on the child nutrition state administrative expenses allows the states to keep these funds for 2 years. Once we grant funds, states continue to have access to them for 2 years.

At the end of 1986, the states reported that they had over $18 million carried forward into 1987. We are proposing legislation that would allow us to use unobligated 1987 money to offset their 1988 entitlement under the law. This $20 million that we are discussing here has actually been built up over a number of years, Mr. Chairman.

Senator BURDICK. Do I understand that it is still available, it doesn't lapse or anything like that?

Mr. BODE. Senator, of course, the concept of first in, first out, applies here, and since the amount carried over is smaller than the total appropriations, it does not lapse. The 1-year carryover authority continues to apply, and that is how the amount has built up.

Senator BURDICK. There is certainly no objection to carrying over the money as long as the states' needs are met in the meantime. You just testified that there is no further demand for this money yet; is that correct?

Mr. BRALEY. The money was not expended by the states after it was allocated to them, so they could have spent that money. It was provided to them so they could spend it, and they did not. I view that as not having the demand for it.

Senator BURDICK. In fiscal year 1981, USDA had been paying for its September meals under the child nutrition programs with appropriations from the subsequent fiscal year. Having reviewed your response to a present audit conducted by the General Accounting Office, I am interested in hearing from you on a few points.

The subcommittee will be in recess until the sound of the gavel.

[A brief recess was taken.]

Senator HARKIN [presiding]. The subcommittee will resume.

CNP ROLLOVER

Good morning, Mr. Bode. I understand that the chairman has already made an opening statement regarding the September meals problem that you have in terms of paying for the September meals with appropriations from the subsequent fiscal year.

I have here your letter to the Comptroller General of the United States. I reviewed it once a few weeks ago, and it has just been brought back to my attention now. I would like to cover a few points with you, if I could, regarding that letter and your response to it.

What is the estimated cost of meals under the child nutrition programs for September 1987?

Mr. BODE. I believe the size of the rollover issue is $167 million, Senator, at this time.

Senator HARKIN. Were it to be determined that funds must be restored to the child nutrition account to assure that meals served in September 1987 are paid for with the current fiscal year appropriations, what is USDA's estimate of what that amount would be?

Mr. BODE. That would be the $167 million figure, sir.

Senator HARKIN. I see. Let me go back to that first question. What is the cost just of the 1 month, September 1986?

Mr. BOLING. About $400 million for that month.

Senator HARKIN. So the answer to my first question is $400 million?

Mr. BODE. Yes, Senator; I am sorry, I misunderstood.

Senator HARKIN. And the answer to my second one is $167 million.

It is my understanding that the amount that could be required is increasing from year to year. Could you please provide the reason for the increases?

Mr. BRALEY. Senator Harkin, the amount has varied from year to year. It changes depending on the amount that is appropriated compared to the actual meal service during that year. It has fluctuated. It was actually much higher in 1980, when the problem, or the situation, first arose. It was some $230 million and then it has varied some since then, and in 1986 it was $167 million, as Assistant Secretary Bode indicated.

Senator HARKIN. Tell me again, what are the reasons for the increases? I asked you what the reasons were for the increases.

Mr. BRALEY. It is actually variations in meal counts. We have an appropriation, and then depending on the number of meals that are served, the shortfall would fluctuate depending on whether the amount appropriated is more than or less than the cost of meal services during that particular year. It has not always gone up, in fact, it has gone down considerably from when the situation first arose in 1980.

Senator HARKIN. Also, please provide for the record, the amount used to reimburse unpaid claims from subsequent years' appropriation for each fiscal year from 1980 to the present.

Mr. BODE. We would be pleased to provide that for the record, sir.

[The information follows:]

Child nutrition shortfall

Fiscal year	*Amount*
1980	$120,100,000
1981	118,200,000
1982	258,300,000
1983	293,500,000
1984	245,700,000
1985	125,600,000
1986	[1] 167,500,000

[1] Estimated.

ANTIDEFICIENCY ACT

Senator HARKIN. Do you intend to make a report, Mr. Bode, to the Congress under the Antideficiency Act, whether or not you agree with the General Accounting Office?

Mr. BODE. We have not received the report, Senator, so I guess, I need to review that once we receive it. If they do conclude that there is an Antideficiency Act violation, we will certainly inform the committees as well as inform the Executive Office of the President, as we have endeavored to keep the Congress and the Executive Office of the President informed throughout this matter.

As far as an official report of an Antideficiency Act violation, I need to review that matter as to whether we would simply defer to GAO in reaching that conclusion.

Senator HARKIN. In your February 11 letter to Mr. Bowsher, have you received any response to that letter at all, has there been a response to that letter?

Mr. BODE. No, sir; there has been no response.

ADJUSTING ALLOCATION FORMULA FOR WIC

Senator HARKIN. Mr. Bode, let me ask you a couple of questions about the WIC program. The fiscal year 1987 Appropriations Act restricted the use of WIC program funds for the purposes of issuing regulations to modify the formula under which state allocations are made.

Please tell the committee whether you have consulted with state WIC directors about your future plans on adjusting the formula, and when you might plan to issue interim or final regulations on this issue?

Mr. BODE. Yes, sir; we have had extensive consultations with the state WIC directors. We had met with them before the committee expressed its views. We have sat down and met with them since then. I personally participated in that.

I want to ask George Braley, the Deputy Administrator of the Food and Nutrition Service for Special Nutrition Programs, who sat through all of those consultations, to elaborate a bit.

Mr. BRALEY. Senator Harkin, as Mr. Bode indicated, we have consulted extensively with members of the WIC community on this issue, and we have a regulation in proposed form that should be published shortly. I think it really represents a good consensus among the WIC directors at the state level as well as federal officials. The regulation will achieve several things. It will maintain the operating level in each state, and also achieve some of our shared objectives of targeting funding for those programs that are serving those people of greatest nutritional risk. It would also allow states to expand on a limited basis in situations where they haven't had opportunities in the past.

I think it has been a good process in terms of cooperation and we have a good product.

Mr. BODE. If I might add, Senator, we felt it was important on this matter to undertake a rulemaking. In the past this formula has not been set through rulemaking. We wanted to do that so that we could have the benefit of the comment period in a rulemaking, and the public would have an opportunity to comment and have an influence on how this important allocation formula should be structured.

Senator HARKIN. Would you please keep the committee informed of your activities in this area, and especially on the public comment period?

Mr. BODE. We would be pleased to.

FUNDING REQUEST FOR WIC

Senator HARKIN. The Food and Nutrition Service states that funds requested for fiscal year 1988 will support an average participation of 3.3 million women, infants, and children in the WIC program. The funding request is for $1.68 billion. The Congressional Budget Office estimates that in order to support a caseload of 3.34 million in fiscal year 1988, $1.715 billion will be required. This is a discrepancy totaling about $28 million.

We are aware that CBO estimates the average monthly cost per person in fiscal year 1988 to be 15 cents higher than FNS. However, I do not see how, if we are operating under other similar assumptions about serving the eligible WIC population, the funding estimates are so divergent.

Would you please try to explain the discrepancy between your figures and CBO, and tell the committee why FNS has not requested more funds for the WIC program?

Mr. BRALEY. Senator Harkin, our request basically supports the current services estimate of about 3.3 million participants from fiscal year 1986. There is a good deal of uncertainty, projecting inflation and food package cost that far in the future. A number of states are implementing a provision that will not allow sales tax to be charged on food purchased as part of the food package.

We have initiatives underway to try to curtail food package costs in states, so it is difficult to say for certain how many people can be served at any particular funding level at this point in time, for fiscal year 1988. There are quite a few unknowns.

Senator HARKIN. You are saying, that is why you haven't requested more funds?

Mr. BODE. Senator, we have requested an increase in the current level. In this time of tight budgets, we felt that an increase in funding for any program was significant. Particularly, keeping in mind the tremendous growth the program has experienced over the last 6 or 7 years.

Senator HARKIN. I am told by counsel that actually what you are doing is going back to the 1986 level, and that the 1987 level was a little higher, so that there is actually some reduction.

What was the 1986 level?

Mr. BRALEY. The funding level or the participation level?

Senator HARKIN. The participation level.

Mr. BRALEY. The participation level in 1986 was right around 3.3 million. It is expected to be slightly higher in fiscal year 1987, and the 1988 request—depending again on how the food price inflation plays out and the food package initiative is taken by the states—would be more in line with the 1986 level.

Mr. BODE. My statement was in particular addressed to dollars appropriated and not to participation levels, since this is a grant program. That was the basis of my comment.

Senator HARKIN. What was the funding for 1986 and 1987? What was the funding level?

Mr. BODE. The appropriation level for fiscal year 1986 was $1,570,000,000.

Senator HARKIN. And for fiscal year 1987?

Mr. BODE. $1,663,497,000.

Senator HARKIN. So, now you are asking for $1.68 billion?

Mr. BODE. Yes, Senator.

Senator HARKIN. You have gone up about $24 million, but you are saying that even though it is costing $24 million more, that you are going to be serving less people. Is that right?

Mr. BODE. Senator, there is that potential. Again, there are a lot of things going on; the sales tax initiative, uncertainty about how much money would be carried over from this year into next year, which remains available to the WIC program.

Senator HARKIN. What is this sales tax initiative? What do you mean by that?

Mr. BODE. Senator, it concerns the charging of sales tax by some states and localities on grocery sales for WIC vouchers. Of course, when this tax is charged, it is a cost which increases the reimbursement on the voucher.

Senator HARKIN. So they have to pay sales tax on this?

Mr. BODE. The initiative we are referring to is exempting WIC vouchers from those sales taxes.

Senator HARKIN. Has that happened? I mean are you exempt?

Mr. BODE. Yes, sir; Congress granted that WIC vouchers not be taxed and that is bringing down the cost of the food package to some extent.

Senator HARKIN. Let me get this right. The states cannot levy sales tax on WIC vouchers. Is that right?

Mr. BODE. Yes; that is now going into effect.

Senator HARKIN. That ought to decrease the cost then. That should mean, with the increased money, you ought to be able to serve more people, not fewer people.

Mr. BODE. Yes; that offsets inflation and other factors that might increase food package costs. It is just one of a number of factors at play.

Mr. BRALEY. Senator, our hope is that the implementation of the sales tax change, not allowing it, would allow the service of additional people, with whatever amount of funds that are ultimately appropriated. That is working in the opposite direction of inflation and other pressures to increase food package costs. That is why we decided that there is potential for service to additional people within whatever funds are appropriated.

Senator HARKIN. The type of food that you can get on a WIC voucher, tell me what that is? What kind of food do you get on a WIC voucher?

Mr. BRALEY. Senator, for infants up to a year of age, the food is mostly infant formula. Pregnant women, postpartum women, and children receive a variety of foods, including dairy products, eggs, cereal that is fortified, juice, and a number of other items that have been specifically designed to supplement the known nutritional problems of that particular target population.

Food packages have been the subject of several rulemaking initiatives over the last several years, and are supplementary to the diets of those individuals.

INFANT FORMULA

Senator HARKIN. I don't understand why it is costing so much more, especially in infant formula. I mean, after all, infant formula is made up of what, milk, and it is made up of some kind of protein substance, probably soy, maybe?

Mr. BRALEY. I don't pretend to be an expert on the manufacturing of infant formula, but most of the ones in use are either based on cows' milk or on soy protein, one or the other is the basic ingredient in formula.

Senator HARKIN. Both of those have not had any inflation, in fact, they have gone down in price. Soy protein has gone down, dairy has gone down considerably in the last couple of years, because of what is happening in agriculture. I can't imagine for the life of me that infant formula could be increasing in price, unless, of course, there is some price gouging done by the infant formula manufacturers. I just can't understand how infant formula would increase.

Ms. KONDRATAS. Senator Harkin, I don't want to comment on price gouging, but it is true that infant formula has been going up faster than the rate of inflation and faster than the rate of milk price increases. The infant formula companies defended these price increases. I think it is significant that the federal government is one-third of their market and this in a sense gives them some leeway in prices.

Senator HARKIN. I understand that. I was looking at some of the prices of infant formula and there are only three companies that manufacture formula, as I understand, in the United States.

Mr. BODE. There are other smaller manufacturers.

REBATE SYSTEM FOR PURCHASING INFANT FORMULA

Senator HARKIN. Let me get into that right now, in fact, I was leading you along to that question. Recently the Food and Nutrition Service indicated, it will permit state administrators to purchase infant formula for the WIC program under a rebate system. Tennessee is contemplating such a plan now, and I understand other states are hoping to contract with the lowest bidding infant formula manufacturer.

Could you give us the status on this rebate program?

Mr. BODE. Senator, the state of Tennessee had asked us for a modification in their state plan to permit that some months ago. We approved that modification, as you indicated. They are in the process of implementing such a system, as far as we know.

Senator HARKIN. If all states participating in the WIC program were to implement a rebate system, what kind of funds are we talking about that might be saved?

Mr. BRALEY. Senator, that is very difficult to predict. We don't really have enough experience at this point to be able to forecast that adequately.

Senator HARKIN. Do you think, personally, there would be some savings?

Mr. BRALEY. I certainly think there is some potential for savings there and it is one of the reasons that we have gone ahead and approved that type of approach in state plans that have requested such a change.

Mr. BODE. We are eager to work with the states in pursuing this initiative and others that show potential for reducing the cost of the food packages.

Senator HARKIN. Would the money received through the rebate be considered unspent food dollars, on income to the WIC program?

Mr. BODE. Unspent food dollars, sir. It is money, in essence, that is recaptured from food dollars initially. Those moneys are food dollars, and we feel it is appropriate, and under the law we feel that we are required to insist that those moneys be used for benefits to provide food for our women, infants, and children.

Senator HARKIN. That money would be used for nutrition support to women, infants, and children?

Mr. BODE. Yes, sir; not administrative costs.

Senator HARKIN. Senator Cochran.

Senator COCHRAN. Thank you very much, Mr. Chairman.

Let me offer my greetings to the members of the panel, who are appearing before the subcommittee this morning, and to thank you at the outset for helping make sure that the budget request this year reflects the provisions of current law with regard to the requirement for providing nutrition benefits to eligible persons. This has been a problem that we have wrestled with for the past 6 years. I congratulate you, Mr. Bode, and your staff for winning what, I know, had to be a tough battle in an effort to get the budget to reflect the provisions of current law.

Mr. BODE. Thank you, Senator. I think Secretary Lyng was very helpful in getting that matter straight. He insisted upon it.

Senator COCHRAN. It has been a problem in the past, because in the eyes of some, it would probably make the subcommittee look bad if we kept ignoring the assumptions that were being made by the administration in the budget submission. the budget submission assumed that legislation would be changed by Congress, and it never was, and it may not be this year. I just wanted to point out that I congratulate you on making that progress.

ADMINISTRATIVE FUNDING FORMULA CHANGE FOR WIC

In looking at this year's budget, I wonder whether your discussion of an administrative funding formula change for WIC has taken into account some of the observations that I have heard from the WIC state directors. I worry that if there is a formula change, it might adversely affect the amount of funds that we are getting in my state and throughout the Southeast. I hear that it might have that kind of adverse impact, and I just hope that before any change is made, a very careful review is given to the possible impacts.

What is the status of any formula change, and is a change contemplated?

Mr. BODE. Yes, sir; there is a change contemplated. We have met extensively with state WIC directors, and before making any such change, we felt it was appropriate this time, for the first time, to undertake those changes through a full rulemaking so that there would be an opportunity for public comment and input on the process.

George Braley, if you would elaborate?

Mr. BRALEY. Senator Cochran, there are really two funding formula changes that we are looking at in the WIC program. There is the food funding formula change that has gone through an extensive process with the states to get their input. I think we have a pretty good package, in that regard, that we will be publishing shortly.

The second area is the administrative funding for the program, and we are just beginning to get input from states on that issue. We have had one meeting in Dallas, TX, with representatives from all over the country to begin to talk about that; however, we are some distance away from having a formal proposal. Whatever we do in this area will be the subject of a rulemaking, and there will be adequate opportunity for input from all states and other interested parties.

Senator COCHRAN. I think one consideration that ought to be made in regard to administrative funding is an incentive program for cost savings. We were talking about the cost of infant formula, for example. If states can save money, they should be rewarded. I don't know how you would do that, but I think a review of the administrative funding, with an idea of providing incentives, would be a good one.

Mr. BODE. Senator Cochran, we appreciate that and share the concern and, I think, share the objective. We will work carefully on that though, so that we don't have a rule that overreacts to one factor or another, and that it is handled in an appropriate manner.

We will be sure to structure in those incentives as best we can for sound management.

COMMODITY DISTRIBUTION PROGRAM REFORM BILL

Senator COCHRAN. I spoke to a group the other day—the American School Food Service Administrators—who were meeting here in Washington, and I pointed out that Senator Dole and I, and others, had joined in introducing a bill, which is called the Commodity Distribution Program Reform Act, S. 236. It seemed to be quite popular with this group. They are concerned about inefficiencies and administrative difficulties in the commodity distribution system.

I know that Ms. Kondratas, in her testimony, talked about bringing about improvements in all aspects of the commodity procurement and distribution systems. I wonder in that connection, whether you have taken a look at this bill. Does it offer some helpful suggestions in improvement of the administration of this program?

Mr. BODE. Senator, we have, and we have worked at great length on other matters, too, intended to improve operations of the commodity purchase and distribution program. I spoke to the same group of school food service directors, and they were receptive to the point I made, that the program is working better now than it ever has before. We should keep that in mind as we talk about it, but it still can and should be improved further.

We feel that this bill will be very helpful. We are still reviewing the bill to determine an official position but, I think, it has a number of very positive suggestions, and we are generally appreciative of that legislative effort.

FOOD SERVICE MANAGEMENT INSTITUTE

Senator COCHRAN. One suggestion that was made to me by some of those from Mississippi, who were here attending that conference, was the possible establishment of a school food service management institution. It was pointed out that school food service is an $8 to $10 billion retail business, in effect, and that we need to concentrate some amount of effort and financial support to instruction, training, and providing management skills to those who are involved in the program.

What is your reaction to that? Is there a need for a formalized management institute?

Mr. BODE. Senator, we are all for training. I think, we certainly can do a better job in so many schools of efficiently using available resources to put the best meal possible before our nation's children.

But, I guess, I am not enthusiastic about the idea of a federal institute. There are many opportunities for training in our land-grant colleges and elsewhere that are more appropriate, and locally available opportunities for training.

In these times of our difficult budgets, I think, loading an additional cost on the federal government for what truly ought to be state and local responsibilities is not sound.

FUNDING LEVEL FOR PUERTO RICO

Senator COCHRAN. I noticed that the budget proposes a decrease from $852,750,000 to $825,000,000 for the nutrition assistance for the Puerto Rico block grant. Is that a misprint or did they just get those numbers reversed?

Mr. BODE. No, sir; you may recall in 1981, when the grant was proposed and enacted, the funding was set at $825 million. That was a bit of a reduction from the funding projected to go to Puerto Rico under the regular food stamp program, but remaining parallel with the regular food stamp program.

We felt at that time, and have consistently testified that the level of funding should be held constant. In 1981, almost 60 percent of the population of Puerto Rico was receiving benefits through the food stamp program.

We felt that allowing inflation to reduce the size of that grant, in essence, in real dollar terms was appropriate as a way to ease down the size of that overall effort. It was changed in the 1985 farm bill. The authorization levels went up and Congress funded it that way, but our position of $825 million has stayed the same.

Senator COCHRAN. Thank you very much.

Thank you, Mr. Chairman.

Senator BURDICK [presiding]. In the last question, you mentioned 60 percent within the food stamp program. Is that normal? Is that the average over the years?

Mr. BODE. It fluctuated depending on the economic conditions, as I recall.

Senator BURDICK. Does it get any better? That is what I am trying to get at.

Mr. BODE. Sir, it has stayed in the 60-percent range, 57 to 58 percent. It fluctuated somewhat with economic conditions, but the level of participation in Puerto Rico was a very sizable portion of their overall population. We would be happy to provide you with whatever information we have on that.

Senator BURDICK. I was hoping there might be some improvement, someway, somehow.

Mr. BODE. In terms of the way the program is operating now, I believe, there is certainly a significant improvement, in terms of the dollars being better used to address the needs of those in greatest need.

The assistance is better targeted to those Puerto Ricans with the lowest income, and their administrative costs have been reduced. So, we feel, there are some very significant successes in Puerto Rico's implementation of this program. I think that they were very pleased with the way the flexibility has been used.

Senator BURDICK. I am not talking about cutting their program. I wanted to know whether the economy is improving.

Mr. BODE. I would be pleased to provide some information. I believe that unemployment has stayed pretty high in Puerto Rico.

[The information follows:]

Average unemployment in Puerto Rico

Fiscal year	*Average unemployment*
1983	23,600,000
1984	21,200,000
1985	21,500,000
1986	19,700,000

SPECIAL MILK PROGRAM

Senator BURDICK. Senator Grassley.

Senator GRASSLEY. Thank you, Mr. Chairman.

First of all, as Senator Cochran and the leadership of this committee has done, I want to welcome you and thank you for your hard efforts to help us with several problems that we have, not only on feeding people who have low nutritional levels, but also helping us get rid of some of our agricultural surpluses.

I want to ask, first of all, about the special milk program. It is my understanding, that in this program, this year, there has been a suggestion that this program would be denied to anybody who has an income that exceeds 130 percent of the poverty level. And, yet, for the school lunch program the school breakfast program, the government helps people who have need up to 185 percent of the poverty guidelines.

I would like to have a justification for the difference in this policy, because it would seem to me that the special needs of both groups would be met with the same policy.

Mr. BODE. Sir, the reason that proposal was made is, in the school milk program, I will ask staff to elaborate a bit, we basically have one eligibility criterion that is applied in the school milk program, and that is the 130-percent limit. That existing determination was what we pegged our proposal to, as part of our overall efforts to direct the assistance to those in greatest need, while reducing nonessential expenditures anywhere we could.

Mr. BRALEY. Senator Grassley, that is essentially it. It is strictly a two-tiered system—milk is either fully subsidized at a free level, or a partial subsidy above 130 percent. To be consistent with our other proposals regarding subsidies for higher income people, we didn't modify the basic structure, we just eliminated the funding for higher income people.

Senator GRASSLEY. But you are arguing, that even though the percentages show an extreme difference, that it is a totally consistent policy?

Mr. BODE. I believe the policy objective is certainly consistent, Senator. In the Lunch program, there are the three levels, below 130, between 130 and 185 percent of the poverty level, and above 185. The only place the line is drawn in the school milk program is at 130 percent of poverty, and so that was what we pegged our proposal to. The objective, once again, is to simply target the assistance to those in greatest need.

STATE ERROR RATE LIABILITIES

Senator GRASSLEY. I would like to have you tell me, what friendly impact of the food stamp program holds states liable for the full dollar value of overissued benefits above the tolerance level of 5 percent. Specifically, I would like to know what the policy aims are, or has this program in any way jeopardized the needs of the truly needy.

Mr. BODE. I don't think so, Senator. Of course, this is a subjective matter, and I am sure there are others who might not share my judgment, but we don't feel it has jeopardized service to those who have those needs and ought to be served by the food stamp program.

The reason is that errors are made in the food stamp program because inaccurate information is received or information received is processed inaccurately. That is why we have errors.

The same kind of errors that cause overissuance, the thing we are attacking with this proposal, causes underissuances at times. We feel that we are actually improving administration of programs, in cutting down on all types of errors, and that has been our experience. There is a tendency for the states that have the highest rates of overissuance, giving benefits to people who shouldn't be getting them, also to have problems with denying people, or not giving people as many benefits as they should be getting.

What we are looking for is the best possible job being done to provide assistance to all those who are eligible for them, without providing assistance to those who are not. We feel that it is going to cut down on all types of errors and result in a better run food stamp program.

Senator GRASSLEY. Has paperwork been increased?

Mr. BODE. Generally speaking.

Senator GRASSLEY. As a result of this program?

Mr. BODE. I think there is one item that has caused an increase in paperwork in the food stamp program. That is a selective application of what is called monthly reporting and retrospective budgeting which is applied to some portions of the food stamp caseload. We have granted waivers very broadly to states in the places where that factor has been shown not to be cost effective. That is the example of increased paperwork in the food stamp program.

Senator GRASSLEY. What cost has that been for that increased paperwork. Is there a dollar figure?

Mr. BODE. I don't have a dollar amount. We will go back and check. We have done a significant amount of research on this practice and a criterion used in granting these waivers is cost effectiveness of the practice. If it is not going to be a cost-effective practice, we are sure not going to force the states to do it.

Senator GRASSLEY. Submit that figure in writing.

Mr. BODE. Yes, sir.

[The information follows:]

Mr. BODE. Senator, I have checked and I am sorry to say that we do not have a dollar amount. However, the Department of Agriculture and the Department of Health and Human Services jointly sponsored a major demonstration of monthly reporting and retrospective budgeting for the caseload receiving both food stamps and AFDC in a local welfare office in Chicago during fiscal year 1982. The evaluation of this experience suggested that a fully operational and smooth functioning monthly reporting system comparable to Illinois would increase administrative costs by about 6 percent.

These data need to be viewed with some caution because the monthly reporting system demonstrated in Illinois differs from current monthly reporting policy in several important ways. First, only the joint AFDC/food caseload was subject to monthly reporting in the demonstration; current policy also applies to food stamp cases not receiving AFDC. Second, the demonstration required monthly reporting for the entire caseload receiving both AFDC and food stamps; current policy permits states to implement targeted monthly reporting would be cost-beneficial. On average, less than a third of the current caseload is in monthly reporting. Finally, in the demonstration, monthly reporting of client circumstances was substituted for one or more recertifications. Current policy implements monthly reporting in addition to conventional recertifications to secure more timely and accurate information on client circumstances.

FOOD STAMP PURCHASES

Senator GRASSLEY. My last question deals with a subject that I am sure you are asked every time you appear before one of the panels up here on the food stamp program, because it is a question that we always get asked. That is in regard to the fact that time and again we have constituents complaining to us, that they are upset when food stamp recipients going to the grocery store buy pop, beer, and candy with food stamps.

Obviously, we know how that can't be done under the regulations, but how it is probably done by the change that people get back. What is it, less than $5?

Mr. BODE. Less than a dollar.

Senator GRASSLEY. Less than a dollar, but accumulating it and buying things with it, or having some discretionary income, that they might spend on food for those things. But that is what we hear. Do you have any rules against that?

Mr. BODE. Yes, sir; we certainly withdraw the authorization for retail stores to accept food stamps in places where those few bad examples of abuse by retailers cause problems of this sort. It is bad for the program. I think it is bad for the entire effort to provide food assistance to those in need. When there is an abuse of this sort, we have a team of people who check to be sure that retailers are complying with rules. As you know, there are about 240,000 retail stores in the country receiving food stamps, and it is a little tough to keep track of it all. We work very diligently to provide the information to the retailer, so they know what is expected of them, and then do some spot checking where we have indications that there are complaints.

Finally, I should note, that while beer is certainly an item that is not authorized for purchase, or any other alcoholic beverage, candy and soda pop can be purchased with food stamps.

Senator GRASSLEY. Let me suggest then, from the standpoint of some things being legal and some things not being legal, but the public feeling that all would be wrong. What sort of efforts do you have then, other than just leasing or in the case of where things are purchased that maybe we consider junk food, is there a program for education, or public information of what really is the best buy?

Mr. BODE. Yes.

Senator GRASSLEY. And the discouragement of buying the things that are less healthy for people who don't have the discretionary income for it?

Mr. BODE. You probably dread it every time you hear a witness say, "I am glad you asked that question," but I am particularly pleased that you raised that point, because we have started an initiative I am particularly proud of, which we refer to as, "Making Your Food Dollars Count," where we provide information through the Food Stamp Program, to how food stamp recipients can make better use of their precious food dollars, to get the most nutritional benefit from them possible. That is an effort that we are very proud of and we would be delighted to provide additional information about that effort. It is a part of our overall efforts to provide nutrition information to the public.

Senator GRASSLEY. Does it get out in a form that is easily understandable and might not be rejected very easily? I would imagine that this is very much an uphill battle.

Mr. BODE. It sure is, Senator, and I don't want to pretend that we have perfected our efforts in every way. I am sure that as time goes on, we can improve further. The materials are prepared and provided at a low reading level so they are very simple to read. We have also provided public service announcements in both Spanish and English. We are keeping in mind that everyone who needs this assistance is not necessarily ready to read a college text on this subject.

Senator GRASSLEY. Mr. Chairman, I have no further questions. Thank you very much.

Senator HARKIN. Thank you.

EXPANDED FOOD AND NUTRITION EDUCATION PROGRAM

Can I just follow up on what my colleague was just talking about, because a little bell rang, and my staff just reminded me about it.

One of the things that I have heard a lot about in my own state of Iowa, and perhaps you have too, is that, in light of what you just said that you were particularly proud of some initiatives that you have underway to inform food stamp recipients and others of best buys of food and things like that, you have also asked to zero out the transfer of money to the expanded food and nutrition education program that goes out to the Extension Service.

I asked some questions about this a few weeks ago of the Department. The EFNEP program, as it is so called, expanded food and nutrition education program, is carried out through the Extension Service.

From everything that I have been able to see, it has been very good at reaching those very low income people and teaching them about the best buys of food and how to plan their budget, and that kind of thing. It goes to these very needy people.

What you are doing—I understand you are transferring something like $38 million—is a transfer from food stamps to the Extension Service for this program. As I understand it, you are trying to cut that down by $38 million. Is that right; do you have the correct figure? I don't.

Mr. BODE. USDA has proposed to discontinue funding for the EFNEP program.

Senator HARKIN. Doesn't this do exactly what we have been talking about?

Mr. BODE. No; I believe it doesn't. It certainly has the same objective, Senator, but I think it addresses the problem in a far different way. EFNEP is a very expensive program per person who receives the benefit of it. In essence, training is provided to individuals, who then go out and work with individuals in their households. I think very small classes go to the grocery store with individuals. As you might imagine, that is a very expensive proposition per person receiving the benefit of it. That is our general concern about the EFNEP program.

I realize that extension personnel are very enthusiastic about this program that they work with, and we have enjoyed working with, and continue to work with, the Extension Service on nutrition education efforts. However, this effort is one that we do not have much enthusiasm for because it is so expensive per person receiving assistance.

Senator HARKIN. How else are you going to get that information to these low-income people? It would almost have to be one on one in some cases.

Mr. BODE. In essence, we are talking about 4,000 professionals who were trained in the EFNEP program. Of course, here again, I would be pleased to defer to Dr. Bentley, who is really responsible for this program. It is not one of the programs that we work with, but there are 4,000 professionals in EFNEP.

Senator HARKIN. 4,000 professionals.

Mr. BODE. 260,000 households were affected last year. Of course, there were some 7 million households in the food stamp program, so we are talking about a relatively small number of households receiving treatment for a rather large amount of money.

Senator HARKIN. You said that there were 260,000 households last year, who were contacted through the EFNEP program.

Mr. BODE. Senator, I am trying to quickly provide you information because we want to be responsive. But because this is not one of the programs that I work with, it is not in my area of jurisdiction. I would greatly appreciate the opportunity to respond fully for the record. I think our statements will be more accurate in that way.

Of course, we would be delighted for Dr. Bentley to respond fully to all your questions when he testifies.

Senator HARKIN. Mr. Bentley has already been here. I have already asked him about this program. What I am saying, though, is that there was a transfer of money from the food stamp program to EFNEP, $38 million. They are zeroing out EFNEP, which I understand the total EFNEP is about $57 million. There is a transfer of $38 million from your Department, the food stamp program.

What I am asking you, as the head of your Department, is: Are you in favor of cutting that $38 million out of that transfer?

Mr. BODE. Yes, sir.

Senator HARKIN. Then that is in your area. You told me, that you have 4,000 people, these are Extension people, that service 260,000 households. Those 4,000 administrators, do they do anything else other than just the expanded food and nutrition education program? Did they do other things with these clients out there, or did they have other types of work that they were involved in?

Mr. BODE. I will have to provide that information for the record, Senator.

[The information follows:]

There are currently 3,349 Expanded Food and Nutrition Education Program [EFNEP] paraprofessionals who teach food and nutrition to 288,872 low-income homemakers, 66 percent of whom are food stamp recipients, and also to 589,000 youth.

The paraprofessionals are employed to teach in EFNEP. They teach both adult and youth, working in conjunction with 107,000 volunteers to extend the educational program. In teaching families how to improve their diet, EFNEP paraprofessionals are trained and supervised by Extension home economists. Program participants are taught to select, buy and prepare food that satisfies nutritional need. In addition, paraprofessionals inform families about federal food programs and teach them how to improve their ability to manage the food budget including food stamps.

Senator HARKIN. I appreciate it. It is my understanding that they do other things other than just food education and nutrition education programs.

I would also point out, as I did to Mr. Bentley, that one fact that you left out, that there are 108,000 volunteers, who volunteer freely of their own time, and in many cases, of their own gas money to drive places in their own automobiles, to make this program work. If you have a program where you have 4,000 professionals, that generates 108,000 volunteers, that seems to me to be a pretty good program. Especially, when a lot of times you have to get down with those people on an individual basis in their own homes, you can't just send them something in the mail and say, "Read this," in many cases, they can't even read that stuff. They aren't going to go to seminars. In many cases, they don't have the transportation to go to some other community for a seminar that you are going to have.

If there is one program that does require a hands-on type of thing, it is just what Senator Grassley is talking about, that education program. I tell you that when you have this thing done through the Extension Service, and I am not carrying any water for the Extension Service, but I see how many volunteers they have, 108,000, and when they reached almost 290,000 households, I have to believe that that is money pretty well spent, when you get that many volunteers.

Mr. BODE. I understand that the number of households in the food stamp program who also received treatment from EFNEP is about 130,000.

Senator HARKIN. I don't understand that last one.

Mr. BODE. There are 260,000 households that were affected last year, about half of them are food stamp households, half of them are not.

Senator HARKIN. I don't understand the point of that.

Mr. BODE. Senator, I guess, there is certainly no disagreement about the objective of providing nutrition education. We do question the effectiveness of the EFNEP program, in terms of its cost of providing that effort to a relatively small number of people for the amount of money that is going into it.

Senator HARKIN. You propose to replace it with what? Tell me again, what is this you are going to replace it with?

Mr. BODE. We have an effort underway called, "Making Your Food Dollars Count," where we have provided materials for use in the food stamp offices. We are not convening big seminars somewhere.

Senator HARKIN. So these materials are in the food stamp offices, which they give to food stamp recipients.

Mr. BODE. Yes; it is a gathering place. Many times, in offices, there is waiting and we try to provide information there, as well as public service announcements and other efforts. It is certainly a much lower cost initiative to provide nutrition information.

Mr. SHERMAN. Mr. Chairman, if I might add something?

Senator HARKIN. Surely.

Mr. SHERMAN. With respect to the Extension Service's effort to supply nutritional information to the needy in this program, that was one of the items with a specifically targeted grant, among several other grants, that were proposed for elimination in the fiscal 1988 budget, leaving $237 million of a broader formula funds available to the local and state extension systems to continue to carry out their programs.

These funds are used together with state funds, local, and private funds, to totally fund all of the Extension activities that are carried out throughout the country, through the state and local extension systems.

The elimination of the specifically targeted items, does not mean the elimination of nutritional assistance and other education assistance in those programs.

Senator HARKIN. If we serve 260,000 households for $57 million, that is about $200 a household per year, and $200 is inexpensive to teach people how to buy food and what to eat, probably make them healthier, probably cut down on medical bills. I think when you say $200 a household, it is not that much.

Mr. BODE. Our concern is about the cost of the program, for the number of people who receive benefits from it. It seems, to us, to be an expensive means of providing nutrition information to low-income households.

Senator HARKIN. It sounds expensive in the total, when you say $57 million, but when you say it costs $200 for an average household per year, and some of those are in rural areas, where you have to drive out to reach these people, and they are not all just living in the city someplace.

Apart from that $200 you have volunteers going out. They teach them how to buy groceries and buy better food. I don't know if you could do it much cheaper than $200 a year. That doesn't seem to be all that expensive, when you look at it that way, $200 for one family per year, and obviously they don't continue on. They do it once or twice. They will do it for a few times, and then they move on to other families. It is not that this same family gets the $200 of education assistance every year for a number of years.

I want to look into this more and any other information you can provide on this I would appreciate, because you are right, we both have the same interests: educating people to buy better food, more nutritious food, to utilize their food stamps better or any other assistance they get better, and to do it in the least cost method. That is what I am interested in too.

Mr. BODE. As I guess you have gathered, I have had quite a bit of information coming in to me via notes.

Senator HARKIN. I sympathize with you, I get that too.

Mr. BODE. Senator, I think you might find it interesting, in the WIC program, which also has a nutrition education component, we are talking about a $16-per-person-per-year cost in WIC for nutrition education efforts. These 130,000 food stamp recipients receiving nutrition information through the EFNEP program——

Senator HARKIN. 260,000.

Mr. BODE. 260,000 is the total, but the number of food stamp recipients is significantly lower. It amounts to only about 2 percent of the food stamp recipients, so we are looking at a small part of it.

Senator HARKIN. It is still less than $300 a year. I still want to look into this. I want to get a better handle on it.

Mr. BODE. We would be happy to work with you on that, Senator, if you would like.

SPECIAL MILK PROGRAM

Senator HARKIN. Let's move off that subject. It caught my ear when my colleague was talking about it, because I had just questioned Bentley about it not more than 2 or 3 weeks ago.

I want to talk about the special milk program a little bit differently than what my colleague from Iowa was talking about.

Could you please tell the committee, how many split session kindergarten programs are estimated to participate in the special milk program in fiscal year 1987?

Mr. BRALEY. How many will participate?

Senator HARKIN. Estimated to participate in fiscal year 1987?

Mr. BRALEY. Those split session kindergartens were just recently made eligible for the program, through legislation that was enacted last year, and our regulations to implement that have just been published. I am going to have to refer to staff and see if I have a number for that, or provide it for the record, Senator.

Senator HARKIN. Provide it for the record.

Please explain, and also supply it for the record, how many you anticipate to participate in fiscal year 1987 and fiscal year 1988?

Mr. BODE. We would be happy to do that.

[The information follows:]

Although USDA can estimate that an additional 1.1 million students per day will receive a subsidized half-pint of milk, we do not have sufficient information to estimate the number of additional schools that will participate in the program.

Senator HARKIN. If you can now, or again provide it for the record, explain why there is a discrepancy between your fiscal year 1988 estimate of $33 million, which about doubles the fiscal year 1987 level of the special milk, and CBO's estimate $26 million in fiscal year 1988?

Mr. BODE. Again, Senator, I think we are going to have to do that for the record.

[The information follows:]

Both USDA's and CBO's estimates of the cost of the special milk program in fiscal year 1988 are based on assumptions about the number of additional kindergarten students that will participate in the special milk program due to the addition of split session kindergarten programs. USDA estimates that an additional 180 million half-pints will be served in fiscal year 1988. Our estimate is based on participation of kindergarten children prior to passage of the Omnibus Budget Reconciliation Act [OBRA] of 1981. CBO estimates that only an additional 100 million half-pints will be served, because they do not believe all eligible kindergarten programs will participate. USDA assumes that since many of these newly eligible children were already receiving milk, it is likely that a high proportion of eligible institutions will apply for reimbursement.

STATE ERROR LIABILITY COLLECTIONS

Senator HARKIN. This is on quality control. The fiscal year 1987 budget estimated that FNS would collect $169 million from states based on their liabilities for errors in overissuing food stamps. Can you tell how much has been collected to date?

Mr. BODE. It is a very small amount, about $1 million.

Senator HARKIN. About $1 million to date?

Mr. BODE. Yes, sir.

Senator HARKIN. We estimated that $169 million would be collected. We have gone through October, November, December, January, and February. We have 5 months gone in the year. We are into our sixth month of the fiscal year, and we have only collected $1 million out of $169 million.

Based on current law, FNS proposes to collect $233 million in sanctions from states in fiscal year 1988. Based upon your collection so far, would you expect the full amount to be collected, of $233 million?

Mr. BODE. Senator, this is certainly a difficult process, because we are still in the stages of review, particularly judicial review, of the initial set of quality control sanctions. We are hopeful that after that first set of quality control sanctions goes through the process, that it will move a good deal more quickly.

At this point, there is a good deal of money at issue, of course, and there are significant incentives for states to fully litigate these procedures. Of course, once again, we get into the situation where the states enjoy the time benefit, or the time value of that money, because there is no authority, in some jurisdictions, for us to charge states interest on claims that are received, which, of course, just encourages them not to expeditiously pay those claims.

We are very hopeful that Congress will change that procedure so that we will have a more timely reconciliation of these sorts of issues.

Senator HARKIN. CBO estimated that only $13 million would be collected in 1988, compared to your estimate of $233 million. That is quite a discrepancy.

Mr. BODE. Senator, I have to be candid with you, we are at the forefront on the quality control sanctions collections issue. We have had collections and settlement from two states. I don't think HHS has had any sanctions that they have dealt with settled yet. We are eager to get through the process fully once, with hopes, especially if some changes are made in the administrative review procedure, of making the process work more quickly.

EXCESS ERROR SANCTION COLLECTIONS

Senator HARKIN. The legislative proposals submitted by the administration would hold back funds from the administrative branch to the states, as a means for imposing dollar-for-dollar liability for benefits issued erroneously in excess of 5 percent. Anticipated savings is estimated at $269 million in fiscal year 1988. Combined with other collection efforts in this proposal, $502 million would be collected from the states in fiscal year 1988.

What is the amount of fiscal sanctions that have been collected from the states in each of the past 5 years, and collectively? You can just give that for the record.

[The information follows:]

Excess error sanction collections

Fiscal year	*Amount collected*
1983	
1984	$1,473,515
1985	[1] –497,500
1986	
1987 (to date)	14,853
Total	990,868

[1] Amount returned after out-of-court settlement.

Mr. BODE. Senator, I can tell you, I suspect the point you are after is that it is a very small amount. Once again, this goes back to the fact that we are new in this process, relatively new, of sanctions against states, and that is part of the effort we are seeking to address with our legislative proposal.

The point I was going to make was that the fact that the collection on these claims is very slow, in my view, somewhat erodes the effectiveness of the quality control sanction system, as an incentive for states to reduce all types of error and to administer the programs most appropriately. We are very eager to make the system work, not only in accurately measuring problems in the food stamp program, but also in getting a much more timely reconciliation of payment of these claims where appropriate.

In that way, states will feel the strongest incentives to administer the program well.

Senator HARKIN. I just wonder if, in this catch-22 situation, error rates are increasing or decreasing?

Mr. BODE. Decreasing. We have seen a trend downward, I think, over the last several years, of some 15 percent. It is a saving, so I keep track. During this administration, we have had a reduction in errors worth some $500 million, because of the decline in the food stamp program errors.

Senator HARKIN. Again, the question is: How does holding back administrative funds from the states affect the ability to continue to reduce efforts? Do you see what I mean?

Mr. BODE. Yes, sir; in many situations, what we think is most appropriate is an increased effort in providing administrative resources. If I understand your point, we are using that as the mechanism for getting a payment on these claims and compelling other sound administration practices.

QUALITY CONTROL SYSTEM STUDY

Senator HARKIN. I only have two other questions.

One, the 1985 Food Security Act required the National Academy of Sciences to conduct a thorough study of the quality control system. It is my understanding, that they are going to examine a number of areas, such as tolerance levels and sanctions, things like that. I understand that the study is expected in May of this year, when the whole quality control system may be brought under question.

What I want to ask you is: Does FNS plan to cooperate with the National Academy of Sciences to consider and accept recommendations affecting state administration and quality control of the food stamp program?

Mr. BODE. Senator, we certainly plan to cooperate with them. I think we have been cooperating a good deal already. We have provided them with a great deal of information. We have had, you may recall, a parallel study effort underway by the Food and Nutrition Service.

We are committed to reviewing the whole process. Once we see what the Academy of Sciences says, we will consider it. We look forward, of course, to making the system as sound as we possibly can. I do feel I should in all candor tell you that we, in this administration, are very deeply committed to structuring incentives as best we can for our programs to encourage sound administration, and that was the basic objective of the quality control sanctions system in 1980 when it was put into place. We think it should be continued, and in fact, strengthened.

Senator HARKIN. The GAO issued a study of the administration of the food stamp program in Illinois. It indicated that there was a very high rate of improperly denied benefits not being restored. I think somebody else alluded to that earlier.

As a result of this report, has FNS conducted any internal audits to assure that benefits are not improperly denied before the 30-day application period?

Second, from the stories that I have seen in Illinois, is that many of these people, whose benefits were improperly denied, never had a chance to reapply, and has FNS taken steps to assure that they are restored?

Mr. BODE. Senator, if you don't mind, Scott Dunn, Acting Deputy Administrator for family nutrition programs will respond.

Mr. DUNN. Senator Harkin, we are taking a look at various case actions in the different parts of the country to examine the situation, see where we stand right now and follow up on that GAO report. We do understand that the state, in that particular instance, is going back and taking a look at the cases involved in order to correctly determine the situation.

Senator HARKIN. Could you give us, again, when you get some of that information, give us that information for the record on what steps are being taken to restore those denied benefits.

ELIGIBILITY REQUIREMENTS FOR SUMMER FOOD SERVICE PROGRAM

My last question. I received a copy of a directive from the FNS regional office in Denver announcing a change in eligibility requirements for sponsors participating in the summer food service program.

The change states that private institutions sponsoring nonresidential programs, such as St. Ambrose College in Davenport, IA, summer program for economically disadvantaged children, could no longer receive benefits, but the same program, if it were at a public university, would continue to receive benefits.

Are you familiar with these changes in the regulations? Are you familiar at all with the program at St. Ambrose College?

Mr. BODE. We are going to have to look into this. I am sorry, none of us are recognizing the issue, and I would like to look into it and get back to you as quickly as we can after the hearing.

Senator HARKIN. All he said was, that types of sponsors eligible to participate: One, public or nonprofit private school food authorities; two, public or nonprofit private residential summer camps; and three, units of local, municipal, county, or state governments. What they said to St. Ambrose is, since you are not a residential summer camp, you can't get SYSP benefits. They have been doing it for about 8 years now, and they just wonder why this has all of a sudden changed.

Mr. BODE. Senator, I think, again, we need to check this out in more detail with our regional office in Denver, but it sounds like it may be a reiteration of past policy, that hadn't been implemented. I will have to get the details on that.

Senator HARKIN. I will give you a copy before you leave. I will have staff give you a copy of this directive.

Mr. BODE. I don't believe we have made a change since 1981 or 1982. We look forward to looking into it, Senator and getting back to you.

Senator HARKIN. Thank you, I appreciate it.

Thank you very much, Mr. Chairman, you're very kind.

Senator BURDICK. Thank you.

CONTINUING SURVEY OF FOOD INTAKES BY INDIVIDUALS

The fiscal year 1988 budget request for HNIS included an increase of $1.5 million for the continuing survey of food intakes by individuals. The Department justifies its increase by stating that data have been evaluated from 1985 and 1986 and would be compared to the decennial nationwide food consumption survey.

Why would HNIS compare data from the intake survey with the nationwide food consumption survey that is almost 10 years old? Dr. Sims, would you please respond to this question.

Dr. SIMS. Yes, sir; I will try. HNIS is the agency responsible for conducting the nationwide food consumption survey and for CSFII, which we conducted in 1985 and 1986. As you know, the nationwide food consumption survey data are collected only every 10 years, and what we found in 1985, was that there were sizable shifts in consumption of particular food products in the intervening 8 years.

Our request for the additional $1.5 million to reinstate the continuing survey really is a reflection of our growing awareness of the Department's need to know both the nutrient content of the food supply as well as how food consumption patterns are changing in the American public.

We will be conducting the new continuing survey in a slightly different fashion than we did in 1985 and 1986. In 1985 and 1986, we concentrated only on women 19 to 50 and their children, 1 to 5 years of age, and also separately selected samples of low-income populations.

In 1985, we had a small sample of men participating. We plan, when we reinstate the continuing survey, to be able to sample across all age and sex groups, and then institute what we call a moving average approach to aggregate the numbers, so that we can provide continuous data output on the dietary status of the American population.

Senator, the data to be collected with the new funds, the fiscal year 1988 funds, will be from a survey done in 1989. That will be compared to the decennial survey, which is underway right now, in 1987. It won't be compared back to the 1977 data.

Senator BURDICK. Thank you.

TEFAP PROGRAM

On January 1987, the President transmitted his message to Congress, requesting deferral of $28.6 million for the TEFAP progam. The state administrators of the program were notified as early as January 13, by telephone and by adjusted letters of credit, that a 29-percent cut in the second quarter funds would be expected.

Administrators were also told that they had to cancel February food orders by January 28.

Under what authority did FNS' regional office notify the states, though Congress had not been officially notified of the deferral request?

Mr. BODE. Sir, it was the notifications. We were, of course, very eager to provide the information to the states as quickly as possible, and did so shortly after the President's budget was announced. That is my recollection.

Senator BURDICK. The President's budget, I have been told, did not contain the deferral request.

Mr. BODE. Sir, I believe, the January 5 budget announced it. The official deferral requests were not transmitted to Congress at that time, but since it was announced, we proceeded to be sure that the states were aware of it for purposes of as sound as possible administration.

Senator BURDICK. The problem is that the Department made the deferral on January 28, yet by telephone notified the offices to cut off the funds on January 13, 2 weeks ahead of time.

Mr. BODE. It was announced in the January 5 budget of the President, as one of the items in the President's budget submission that deferrals for a large number of programs, including TEFAP, were proposed.

Mr. SHERMAN. Mr. Chairman, if I might add, to try and clarify the issue, the Congress and the President mutually agreed to submit the budget of the President in two stages this past year. On January 5, the initial stage of the President's budget was submitted, and at that time, some general and basic information about the deferrals was provided, as a part of that submission.

The actual detailed technical documents to back that up were a part of the second stage of the submission, on January 28. It makes it sort of a gray area as to when the official notification occurred on this item, but it was included in the materials that were provided to the Congress on the fifth. The backup documents were provided on the 28th.

Senator BURDICK. The problem that I see here, in all this confusion, is that the January 5 deferral is not an official request. It is not firm.

Mr. SHERMAN. I believe that the administration feels that their submission on January 5 was an official request in the cycle of budget submissions agreed to with the Congress.

Also, with regard to this item, due to a followup action by the Congress, that deferral was ended on February 13, and the funds were then made available to the states.

Senator BURDICK. Congress couldn't do a thing until they were officially informed of that deferral; they couldn't do a thing. Are you saying that the Congress was officially advised of the deferral on January 5?

Mr. SHERMAN. Mr. Chairman, I believe, that I would have to defer to the Office of Management and Budget to make a final determination on the executive branch's formal notification.

Mr. BODE. Mr. Chairman, we appreciate your concern on this point and, if you don't mind, what we would like to do is contact our colleagues at the Office of Management and Budget.

Senator BURDICK. I would be glad to have some light shed on this, because it is kind of confusing at the moment.

TEMPORARY EMERGENCY FOOD ASSISTANCE PROGRAM [TEFAP]

NOTIFICATION OF DEFERRAL

The "Rescissions, Deferrals, and Revised Deferral Message" from the President of the United States was transmitted to the Congress on January 28, 1987. This message included the proposal to defer TEFAP funds pending congressional consideration of proposed supplemental appropriations language to transfer funds to other accounts of the Department to fund the cost of the January 1987 pay raise and increased Federal Employees Retirement System costs. However, the Budget of the United States Government, fiscal year 1988 submitted to the Congress on January 5, 1987, includes on page 4–37, reference to the proposed transfer of $28,559,000 of TEFAP funds for increased pay and retirement costs.

SUBMITTED QUESTIONS

Senator BURDICK. I have additional questions to be submitted for the record, and they would be from Senators Burdick, Bumpers, Kasten, McClure, Sasser, and Harkin. I would appreciate it if you would respond to them in writing, in an expeditious manner for the record.

[The following questions were not asked at the hearing but were submitted for response for the record:]

FOOD AND NUTRITION SERVICE

QUESTIONS SUBMITTED BY SENATOR BURDICK

SPECIAL SUPPLEMENTAL MILK PROGRAM

Question: The Administration has requested an additional $3.4 million supplemental appropriation for the Special Supplemental Milk Program in Fiscal Year 1987. These funds will be used to pay for an additional 46 million half-pints of milk in split-session kindergarten programs. What is the basis for your request for supplemental funds in Fiscal Year 1987?

Answer: Due to H.R. 7, we estimate that an additional 46 million half pints would be served based on participation in the Special Milk Program by kindergarten children prior to passage of The Omnibus Budget Reconciliation Act (OBRA) of 1981. OBRA prohibited schools that operated the National School Lunch Program or School Breakfast Program from operating the Special Milk Program. The supplemental request of $3.4 million is based on a total anticipated cost of $19.8 million in Fiscal Year 1987, an appropriation of $14.9 million and approximately $1.5 million in funds carried over from Fiscal Year 1986.

Question: Can you please tell the committee how many split-session kindergarten programs are estimated to participate in the Special Supplemental Milk Program in Fiscal Year 1987?

Answer: Although we can estimate the number of half pints based on pre-OBRA data, we do not have sufficient information to estimate the number of additional kindergartens that will participate in the program in Fiscal Year 1987.

Question: How many do you anticipate to participate in Fiscal Year 1988?

Answer: For the same reasons that we are unable to provide an estimate for the number of kindergartens participating in Fiscal Year 1987, we cannot provide an estimate for Fiscal Year 1988.

Question: Please explain why there is a discrepancy between your Fiscal Year 1988 estimate of $33 million--which almost doubles the Fiscal Year 1987 level for the Special Milk Program--and CBO's estimate of $26 million in Fiscal Year 1988 for this Program?

Answer: Both USDA's and CBO's estimates of the cost of the Special Milk Program in Fiscal Year 1988 are based on assumptions about the number of additional kindergarten students that will participate in the Special Milk Program due to the addition of split-session kindergarten programs. USDA estimates that an additional 180 million half pints will be served in Fiscal Year 1988. This estimate is based on participation prior to the 1981 law change. CBO estimates that only an additional 100 million half pints will be served, because they do not believe all eligible kindergarten programs will participate. USDA assumes that since many of these newly eligible children were already receiving milk, it is likely that a high proportion of eligible institutions will apply for reimbursement.

SUPPLEMENTAL NUTRITION ASSISTANCE (WIC)

Question: I am aware that CBO estimates the average monthly cost per person in Fiscal Year 1988 to be 15 cents higher than FNS; however, I do not see why if we are operating under other similar assumptions about serving the eligible WIC population the funding estimates are so divergent.

Please explain the discrepancy and tell the Committee why FNS has not requested more funds for the WIC Program.

Answer: The differences are due to the slightly different economic assumptions of CBO and the Administration, but they have small impacts on our budget proposal. In fact, the 15 cents represent a difference of less than 0.4 percent. In order to compute WIC costs per person in Fiscal Year 1988, both the Department and CBO start with Fiscal Year 1986 reported costs and adjust these for inflation in Fiscal Years 1987 and 1988. CBO started with a Fiscal Year 1986 base cost of $39.79 per person and inflated by 4.1 percent in 1987 and 3.1 percent in 1988. The Department started with a base cost of $39.85 in Fiscal Year 1986 and inflated by 3.07 percent in 1987 and 3.59 percent in 1988. The base 1986 costs came from different reporting periods and differ a little due to changing State reports. The inflation factors are similar conceptually: CBO uses the Consumer Price Index for Food at Home and the Department uses the Thrifty Food Plan index. These indices differ somewhat due to differing macroeconomic assumptions of CBO and the Administration.

The Department's budget proposal for Fiscal Year 1988 essentially represents inflating the Fiscal Year 1986 appropriations for food price inflation. The budget proposal is to fund the program in 1988 at the participation of 1986. We believe it is an appropriate level and will stabilize participation in WIC. Further program improvements should come from better targeting of available funds to the neediest.

It is important to note that it is difficult to project the true cost per person in WIC in Fiscal Year 1988. Food price inflation may differ from CBO's or our projections. More important, programmatic changes, such as eliminating food sales tax on WIC items (estimated savings may be up to $11 million in Fiscal Year 1988) or other program efforts to reduce food costs, such as infant formula, should be considered. These influences, not included in either set of formal economic assumptions, may decrease the real WIC costs per person next year.

Question: The budget justification states that the Fiscal Year 1988 request is offset by a slight decline in participation from the Fiscal Year 1987 level of 3.4 million average monthly participants.

This slight decline is estimated at a monthly average of 100,000 WIC eligibles. I have two questions about this offset:

How can FNS justify a decrease in WIC participation when we know that the program is now serving only about one-third or less of the eligible population?

Answer: I would first point out that the WIC Program serves significantly more than one-third of the eligible population. The one-third figure only refers to income-eligible persons. This does not account for a very important eligibility criteria, nutritional risk. Not all income-eligible persons are at nutritional risk. If nutritional risk were accounted for, the pool of eligibles would be reduced and the percent served would be higher. Further, the WIC Program is serving a higher percent of high priority participants, such as infants and pregnant women. Moreover, the percent of income-eligible people served is the highest in the program history. Despite budgetary constraints in all programs, WIC has grown steadily since its inception. Finally, about one-ninth of the participants leave the program each month due to normal attrition.

The Department is proposing a relative stabilization of the number of WIC participants. The level of expected WIC participation in Fiscal Year 1988 under our budget proposal is difficult to estimate precisely, due to uncertain levels of unspent funds available and reductions in food costs per person which may permit more people to be served with the same funds. For example, the elimination of more sales tax on WIC food items and other methods to reduce food costs, such as infant formula. may increase the number of people who can be served under the budget proposal. The estimate cited of a 100,000 participation reduction is too high. If there are no changes in food costs other than inflation, we estimate a 70,000 reduction and the Congressional Budget Office projects 50,000 below current participation.

Question: Often FNS is quoted as using 1960 Census data that would tell us that there are about 8.4 million WIC eligibles. But, in reality, more recent information tells us that based on income there may be more than 10 million persons who qualify for the program. Why does not FNS update its assumptions about the numbers of women, infants and children that are income eligible so that we can all get a better picture of the current budget requirements for WIC?

Answer: We do update them. Based on the most recent Census information, the March 1986 Current Population Survey, we estimate that there were about 10 million people income eligible in 1985. A smaller number would meet both the income and nutritional eligibility standards. We plan soon to complete and release a WIC Eligibility Study which estimates the number of people who are eligible by category, income and nutritional risk.

Question: In the Fiscal Year 1987 report of the Committee, FNS was directed to get underway a follow-up study on the National WIC Evaluation. As you may be aware, the Committee is interested in pursuing a longitudinal study of WIC Program participants and would like to build on to the existing pool of information and the extensive analysis that the National Evaluation provided.

Would you please inform the Committee of your progress in initiating this study and when we can expect it to be under way?

Answer: The Agency has carefully examined the issue of a follow-up study to the National WIC Evaluation, which would recontact the original sample, and has concluded that it is not technically feasible or desirable to conduct such a study. This conclusion was also reached by two nationally recognized and impartial experts, namely, Dr. David Paige from Johns Hopkins University (research pediatrician and local WIC Administrator) and Dr. Thomas Cook from Northwestern University (research and design methodologist). At the same time, the Agency continues to recognize the importance of examining the long-term effects of WIC participation on infants and children and, over the last few months, has actively reviewed several alternative research strategies which would form the basis of a new study. We will brief Congressional staff about these strategies on March 20 and seek their comments in order to design such a new study.

Based on serious deliberations thusfar, no single research strategy has yet emerged that is free of major design flaws. As a result the Agency intends to conduct a design competition--open to all researchers--whereby the Agency will make multiple awards to a limited number of bidders. As soon as this design competition phase is complete, the Agency will be in a much better position to determine if any of the designs are feasible, to establish the actual start-up date for new data collection, and to estimate total study costs.

Question: What do you anticipate the cost of this study to be?

Answer: The cost of conducting a national WIC longitudinal study of a large number of infants and children is estimated to cost between $10 and $15 million and would take approximately 8 to 9 years to complete. However, the Agency is currently examining alternative research strategies which may be less costly, provide data sooner and avoid some design flaws inherent in studying WIC participants. When these alternative designs have been reviewed, the Agency will be in a better position to provide more accurate cost data.

Question: Recently, FNS indicated that it will permit State Administrators to purchase infant formula for the WIC Program under a rebate system. Tennessee has such a plan underway, and I understand other States are expected to contract with the lowest bidding infant formula manufacturer.

Would you please provide the committee with a status on this rebate system?

Answer: Several States have expressed interest in a rebate system in which the State would request bids for a contract to provide all infant formula for the WIC Program (except alternative brands prescribed by physicians). Bidders are invited to compete based on net price, that is, wholesale price minus a per-unit rebate.

Three States, Tennessee, South Carolina and Oregon, have actively worked toward implementation of such a system. State Plan of Operations modifications to provide for the purchase of formula under the rebate system have been approved for both Tennessee and South Carolina. Tennessee executed a contract in late February with Wyeth Laboratories, the only bidder on the State's contract, based on a rebate of 40 cents. This resulted in a net price of 79 cents for soy-based formula and 81 cents for milk-based formula. The contract will become effective in June 1987. South Carolina has temporarily halted its rebate initiative for a variety of reasons, including appointment of a new Commissioner of Health. Oregon is beginning its rebate initiative by developing a Request for Proposal and by scheduling a hearing on April 3 to receive public comments on its proposal to amend the State Plan to include a rebate provision.

Question: If all states participating in the WIC Program were to implement a rebate system, what level of funds would be saved?

Answer: The level of rebate savings depends on the amounts bid by formula manufacturers. While we know that one manufacturer bid a 40 cents per can rebate in the State of Tennessee, it is unclear that these levels would be valid if every State had a rebate system. The bids might change due to business decisions and strategies of companies. For example, States located further from the manufacturing plants might get lower rebates, due to higher shipping costs. If the competition became weaker, the rebates may decline. If competition became stronger, rebates may increase.

Any rebate savings would be used to increase participation in a State; it would not decrease Federal spending.

Question: Would the money received through the rebate be considered unspent food dollars or income to the WIC Program? Would this money be redirected into the program:

-- Would it provide more funds solely for food? or,

-- Would it be used for nutritional support to mothers, infants, and children in WIC as well?

Answer: The money received through rebates would be considered unspent food dollars and, as such, would have to be used exclusively to pay for program food packages for additional participants.

The State would not be restricted to using this food money only for infants. Any category of participant could benefit, consistent with the usual intake processes of the WIC Program. No portion of the rebate funds could be diverted from the purpose for which the State originally received them in order to increase State agency administrative funding. Each dollar thus diverted would diminish the resources available to provide supplemental foods to low-income women, infants, and children at nutritional risk, thus undercutting the purpose of rebate systems as a means to free up more food funds.

Rebates would not be considered "program income" because they do not meet the definition in Uniform Federal Assistance Regulations, i.e., "gross income earned by a recipient from activities supported by a grant or cooperative agreement. . ." Funds from rebates do not qualify as program income, because the State would not "earn" them by delivering goods or providing services. Rather, rebates are a reduction to the food costs which the State incurs, as purchaser of infant formula. States that have lower food package costs cannot use saved food dollars to cover their administrative expenses. These savings do not lose their identity in the rebate process and can only be used to purchase more food for additional participants. Whereas "program income" could be used to cover any program cost, rebates could be used only to purchase food.

However, it should be noted that we are in the process of developing a new funds formula to allocate state administrative and program services funds. The formulas under consideration are based primarily on participation. Under a participation-based formula, the more participants a State agency serves, the more administrative funds it would receive. While the total amount of administrative dollars will remain fixed at 20 percent of the appropriation, States will have added incentive to increase participation through cost-saving measures in order to receive a larger share of the available funds.

Question: How many additional participants could be served by WIC?

Answer: We cannot reliably predict the rebate levels which may be offered by formula manufacturers, if the system were implemented on a broader basis. Thus, we cannot estimate the number of additional participants that might be served.

TEMPORARY EMERGENCY FOOD ASSISTANCE PROGRAM

Question: The General Accounting Office (GAO), in a report on the management of Federally-owned and donated surplus foods (GAO/RCED-86-11, December 5, 1985), stated that the Food and Nutrition Service and the four states GAO reviewed generally did not ensure that State and local inventory systems for TEFAP were implemented as designed. GAO said that although actions had been taken to improve the States' inventory system, FNS needed to improve its oversight of the States' programs. Given that the Administration's Fiscal Year 1988 Budget Proposal does not include TEFAP funds for storage and distribution purposes, how will this affect the quantity and quality of food distributed to the needy and unemployed?

Answer: It is anticipated that State, local and voluntary resources would be used for intrastate storage and distribution. Prior to the authorization of administrative funding through the Temporary Emergency Food Assistance Act of 1983, huge quantities of surplus foods were successfully distributed to needy Americans through public and private initiatives without Federal administrative funding.

Question: Has FNS implemented GAO's recommendations to require FNS Regional Offices to (1) periodically evaluate the States' inventory management systems; and (2) review the State monthly inventory reports.

Answer: We have done several things to improve inventory management for TEFAP commodities. First, regulations (Section 251.9(f)) were strengthened to require that States develop a monitoring system and conduct reviews of participating agencies. Each review must cover a number of areas including food ordering, inventory controls and storage and warehouse practices. Second, USDA has conducted special initiatives, such as the Food and Nutrition Service (FNS) Northeast Region's Warehouse Shelf Life Project. Under this initiative field staff from FNS reviewed all warehouses in the Northeast Region to determine if foods in storage exceeded their shelf life. Potential problems with foods near the end of their shelf life were noted and corrective actions were taken.

Question: Please provide the committee with a record of the inventories of commodities by type and outlet provided over the past five fiscal years.

Answer: The following shows the quantities of commodities provided to States for distribution through TEFAP, by commodity, for Fiscal Years 1982 through 1986.

(in millions of pounds)

	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	CUMULATIVE
Butter	6.5	157.7	141.2	119.1	70.6	495.1
Process Cheese	115.2	364.8	366.3	403.2	410.2	1,659.7
Cheddar Cheese	-0-	48.3	108.3	39.8	-0-	196.4
Nonfat Dry Milk	-0-	30.0	72.7	80.0	93.4	276.1
Cornmeal	-0-	14.1	38.9	35.4	37.4	126.2
Flour	-0-	14.6	56.1	106.9	127.3	304.9
Honey	-0-	10.6	59.4	69.3	78.0	217.3
Rice	-0-	12.9	7.4	75.9	130.7	226.9
All Commodidities	121.7	653.0	850.3	929.6	948.0	2,502.6

Data as of 03/03/87

Question: Do you project any shift in the amount and type of commodities available for donation in the next two fiscal years?

Answer: The amount and types of commodities available for donation to TEFAP will remain the same through September 1987. National monthly allocations of the following types and amounts are available for Fiscal Year 1987:

Cheese	–	35 million pounds
Butter	–	6 million pounds
Nonfat Dry Milk	–	8 million pounds
Flour	–	12 million pounds
Cornmeal	–	4 million pounds
Milled Rice	–	15 million pounds
Honey	–	8 million pounds

Distribution levels for Fiscal Year 1988 have not been determined.

Question: Are current donations coming from new acquisitions or existing stocks? Is our stockpile for certain commodities declining? If so, which ones?

Answer: Current donations are coming primarily from existing stocks. Dairy products such as cheese and nonfat dry milk have exhibited dramatic declines. A comparison of 1986 and 1987 CCC uncommitted inventories for dairy products on March 1, 1987 are as follows:

	1986 (million lbs.)	1987 (million lbs.)
Butter	239	202
Cheese	600	345
Nonfat Dry Milk	975	154

Question: The Food Security Act of 1985 requires FNS to conduct a study of TEFAP program participation for Congress by April 1, 1987.

What is the status of this report?

Answer: The study will be delivered to Congress on time.

NUTRITION PROGRAM FOR THE ELDERLY

Question: With respect to the Committee report accompanying the Appropriations Act for Fiscal Year 1987, there was expressed some concern that limiting the distribution of bonus commodities would hinder the effectiveness of the Nutrition Program for the Elderly in meeting the nutritional needs of senior Americans, particularly for senior sites that operate on a cash-in-lieu of commodities basis.

How many States are currently operating on a cash-in-lieu of commodities basis?

Answer: States are allowed to take their commodity subsidy in all commodities, all cash, or a combination of cash and commodities. For Fiscal Year 1987, 31 States are taking all cash subsidies and 25 States are taking a combination of cash and commodities. Although many States are taking some donated foods, the overall value is less than 6 percent of the level of USDA support for the program.

Question: What commodities would these States normally receive if they were not operating on this basis--excluding the bonus commodities?

Answer: States opting to receive all or a combination of commodities are eligible to receive the full range of donated foods that schools receive. These foods are: meat, poultry, fruits, vegetables, grains, oil and dairy products. In addition to receiving all the above foods, States electing at least 20 percent of their commodity subsidy in commodities are eligible to receive additional beef, flour and any other foods that are determined by USDA to be in excess.

Question: How is it that not providing bonus commodities enhances your policy to enable nutrition program for the elderly sites to "serve elderly persons by providing nutritious food and by encouraging the sites to be outlets for additional commodities whenever available through USDA surplus removal programs,"--as stated in your letter of February 18, 1987?

Answer. The Department does provide bonus commodities to Nutrition Program for the Elderly sites. Any site can receive surplus dairy products and honey. However, there is a second group of bonus foods that includes fruits, vegetables, flour and meat. The second group of foods is provided only to States that order a minimum part of their NPE grant as commodities. In Fiscal Year 1986 there was a threshold of 50 percent of the grant, but it was lowered to 20 percent later in the year.

The reason for the threshold is to encourage States to use more USDA purchased commodities.

Increased participation by NPE sites in the commodity distribution system enhances the Department's ability to serve the dual purpose of providing nutritious agricultural commodities to the elderly and establishing outlets for commodities acquired through surplus removal activities to aid American farmers suffering from depressed market conditions.

SCHOOL LUNCH

Question: Between Fiscal Years 1984 and 1985, the total number of participating schools and residential child care institutions in the school lunch program declined from 89,600 to 89,051.

Are you aware of any reason for this downward trend in participating schools and institutions?

Answer: FNS program records indicate the decline in participating institutions that you cited occurred between Fiscal Years 1984 and 1986. There have been no policy changes between Fiscal Years 1984 and 1986 that would have caused schools to drop the program. The most likely explanation for the decrease in the number of participating institutions is school consolidations. This expla-nation is buttressed by changes in enrollment and participation. Although fewer schools are participating, the total number of stu-dents who have the programs available is about the same. Average daily participation has actually increased by over 500,000 students.

Question: Do you expect more to drop the program?

Answer: We do not anticipate that any schools will drop the program. If consolidations continue, however, the total number of institutions in the program may continue to decline.

Question: What is your estimate of the number of participating schools and child care institutions for Fiscal Year 1987?

Answer: In October, 1986, 89,593 schools and child care insitutions were participating in the School Lunch Program.

Question: Between Fiscal Years 1984 and 1986, an estimated 23.4 million to 23.6 million children participated in the School Lunch Program. Your budget estimates that 24.4 million children are expected to participate daily in the School Lunch Program in Fiscal Year 1987.

In addition, your Fiscal Year 1988 budget estimate anticipates that due to increased school enrollments, 62 million more lunches will be served than in Fiscal Year 1987.

How many more students will participate in the School Lunch Program daily? (Approximately 300,000?)

Answer: The increase in daily school lunch participation will be approximately 370,000.

Question: Why does it appear that more children, but fewer schools are participating in the School Lunch Program?

Answer: There are a number of reasons that could explain why this is happening. Since 1985, the number of school children has been increasing due in part to increased birth rates in the population. These children are now in elementary school. This age group traditionally participates most frequently in the National School Lunch Program. We do not have any specific answers to why the number of schools in the program is declining. School consolidations may still be occurring.

Question: If the Administration's proposal to eliminate lunches to children living in families above 185 percent of poverty were accepted by Congress, your budget estimates that $536 million could be saved in the School Lunch Program.

How many students would this affect daily?

Answer: The proposal would affect the students who pay full price for their meals. There are about 12.6 million paid students in Fiscal Year 1986. It should be noted that these students can afford to pay an extra 25 cents for their meals. The median income for these households is over $39,000, based on the March 1986 Current Population Survey.

Question: Isn't it true that eliminating the cash and commodities subsidies for non-poor students will affect the ability of schools serving meals to students at all income levels?

Answer: We don't believe that will happen. Schools most affected by the proposal will retain over 80 percent of their revenues. Schools retaining such high revenues would have substantial incentives to stay in the program. The average school, which serves about half its meals to full price students, will retain over 90 percent of its current revenues. This should not affect the ability of schools to provide meal service to students.

Question: Wouldn't the Administration's proposal increase costs to schools that might continue to participate in the School Lunch Program?

Answer: We don't believe that meal production costs will change. We expect that schools will pass along the added costs to upper income students in the form of a price increase. While some paying students may choose not to pay the higher price, the vast majority will recognize that the School Lunch Program is still a bargain compared to alternative lunches and will continue to participate in the program. While schools will retain free, reduced, and bonus commodities subsidies, revenues may decline a little. Average meal production costs should not be affected.

Question: How many schools would drop out of the School Lunch Program, if the Administration's proposal were adopted?

Answer: We don't expect schools to drop out of the program. Even those schools most affected by the proposal, schools which currently serve 80 percent of their meals to children in the full price category, will continue to receive over 80 percent of their revenues from Federal subsidies and childrens' payments. It makes good business sense for schools to remain in a program that provides such significant support.

SCHOOL LUNCH COMMODITIES

Question: Under the Administration's legislative proposal, if schools were to drop out of the School Lunch Program. What would you do to encourage the continued use of surplus and bonus commodities by schools?

Answer: We do not anticipate that schools will drop the National School Lunch Program as a result of the Administration's proposal to eliminate subsidies for paid meals. However, if some schools do discontinue their participation in the National School Lunch Program, they would still be eligible, under current policy, to receive CCC bonus commodities--that is, cheese, butter, nonfat dry milk, rice, and honey.

Question: In 1982, several pilot projects were initiated to allow cash-in-lieu of Federal commodities to schools or commodity letters of credit for purchasing specific commodities. Does USDA plan to continue these pilot projects? For how long?

Answer: The Department does not plan to continue the pilot projects. The study of Alternatives to Commodity Donation ended after School Year 1984-85 and USDA's Food and Nutrition Service submitted a final report to Congress detailing the results of the study in April 1986. No further study is being done. However, P.L. 99-198 extended the provision of cash or commodity letters-of-credit to the 60 demonstration sites until June 30, 1987. The Department plans to return all sites to the regular Commodity Distribution Program for the 1987-88 school year.

Question: One of the reasons that has been cited in favor of pilot projects where cash or vouchers are substituted for surplus commodities is that the current delivery system for USDA commodities is not dependable, that commodities are often spoiled or damaged, or that the mix of commodities is not adequate to meet institutional needs.

With respect to food deliveries, I understand that you currently have in place an Interagency Task Force working on food delivery problems. Would you please tell us about this Task Force and report on its accomplishments?

Answer: Secretary Lyng established a high level tri-agency task force to deal with the Food Distribution Program concerns. The task force, chaired by the Under Secretary, consists of senior staff and policy officials, e.g. Assistant Secretaries and Administrators responsible for AMS, ASCS and FNS. The task force will ensure systematic on-going review of domestic commodity distribution issues. In this forum, decision-making regarding issues will serve both the agricultural and consumer interests of the commodity programs. The task force has identified the vulnerable program areas and is still deliberating which specific actions can be taken to increase responsiveness to our customers without undermining the Department's agricultural goals. These actions include expanding the variety of commodities and pack-sizes available and improving the delivery system.

Question: What is USDA doing to respond to other criticisms concerning the use of surplus commodities by public and non-profit institutions?

Answer: The Department has developed commodity fact sheets, a recipe card file and a commodity specifications instruction for distribution to States. We hope to reprint and distribute fact sheets to local agencies. Recently, we met with States to draft Standards of Practice targeted to provide uniform high quality service to schools in all States. We plan to continue to analyze State Food Distribution Program Advisory Council reports, respond to their recommendations and pursue program improvements accordingly.

Question: Two legislative proposals have been introduced in the 100th Congress to improve commodity distribution activities under the School Lunch Act: S.236 and House Bill H.R. 1265. Have you reviewed these legislative proposals?

Answer: The Department is generally supportive of efforts to improve the commodity program as advocated by the American School Food Service Association. We believe that many meaningful changes can be accomplished without the need to increase overall spending. We do have several minor concerns with specific items in various versions of this bill and have identified those concerns in our legislative reports to the authorizing committees.

Question: Would there be a Federal cost in implementing the improvements proposed by these bills? Would there be costs to the Food and Nutrition Service, or other agencies at USDA?

Answer: The two bills to improve commodity distribution activities would entail some additional costs for the Food and Nutrition Service and other USDA agencies. These costs are small and could be met within current budgets.

Question: The Administration's legislative proposal for commodity procurement would result in an increase of $9.6 million in Fiscal Year 1988 if enacted along with other Child Nutrition Program changes. Please explain how your proposal would impact each of the Child Nutrition Programs in Fiscal Year 1988?

Answer: The cash/commodity support mix proposed by the Administration would affect two Child Nutrition Programs: the National School Lunch Program (NSLP) and the Child Care Food Program (CCFP). The proposal is designed to maintain the same dollar level of commodity support to schools as provided in Fiscal Year 1987. For the NSLP this proposal is budget neutral. The distribution of paid and other meals is different in the CCFP than in the NSLP. The $9.6 million increase occurs in the CCFP because the Administration's proposal ties the mix of cash and commodities to NSLP proportion. Total per meal subsidy levels (cash and commodities) for free and reduced price meals would be unchanged.

Question: What would be the level of commodities provided to each Child Nutrition Program in comparison to the levels available under current law?

Answer: I will provide that information for the record.

	Current law 1988 ($ mil.)	Proposed 1988 ($ mil.)
School Lunch Program	$ 485.4	$ 485.2
Summer Food Service Program	.9	.9
Child Care Food Program	18.9	28.7
TOTAL	$ 505.2	$ 514.8

SCHOOL BREAKFAST PROGRAM

Question: The President's legislative proposals for the School Breakfast Program would eliminate cash and commodity subsidies to non-poor children and institute a means test for Family Day Care Home participants. Despite these proposed changes, the President's budget request would increase program funding by $746,000 in Fiscal Year 1988. What is the reason for this increase?

Answer: Under proposed law, FNS estimates that the School Breakfast Program (SBP) would cost $454.5 million in Fiscal Year 1988; this compares with a current law cost of $453.7 million in Fiscal Year 1987. The cost increases despite the proposed elimination of subsidies for paid meals for several reasons. Paid meals represent only 11 percent of total SBP meals and paid meals are reimbursed at a much lower level than free or reduced price meals. In addition, increases are expected in free meals, from 522 to 530 million, and the per meal reimbursement rate for free and reduced price meals is expected to increase due to an inflation adjustment. These factors in combination are larger than the savings due to the proposed legislation.

Question: The Child Nutrition Amendments of 1986 increased the per meal reimbursement rates under the School Breakfast Program. Will the Administration propose to reduce those rates?

Why or why not?

Answer: The 1986 amendments increased reimbursement for the breakfast program by three cents. We have implemented that change and have not proposed repeal of the provision in the Fiscal Year 1988 budget.

Question: How many schools are participating in the School Breakfast Program in Fiscal Year 1987? How many day care homes are participating in the program in this fiscal year?

Answer: In October 1986, 36,769 schools are participating in the School Breakfast Program. Also, 84,738 day care homes participate in the Child Care Food Program.

Question: Do you expect these numbers to increase in Fiscal Year 1988 under current law?

Answer: We expect in Fiscal Year 1988 that more schools will participate in the School Breakfast Program and that more day care homes will enter the Child Care Food Program. The number of schools currently serving breakfast totals about 40 percent of the number of schools participating in the National School Lunch Program. Over the last 6 years the number of schools and day care homes participating in the programs has increased at a yearly average rate of 1.5 percent and 10.8 percent respectively. Growth in both schools and day care homes is expected to continue.

Question: How many schools and day care homes will receive "severe need" assistance during this fiscal year? Under current law, will this number increase in Fiscal Year 1988?

Answer: In Fiscal Year 1987, 18,158 schools will receive "severe need" assistance. Day care homes are not eligible for "severe need" assistance. Under current law, we expect little, if any, increase in the number of schools receiving "severe need" assistance in Fiscal Year 1988.

Question: Why is the Administration proposing to freeze the "severe need" rate of reimbursement to schools with the largest populations of low-income children?

Answer: The administration believes the regular rates of reimbursement are adequate for all schools. This change will be phased in over four or five years to provide transition for schools currently receiving the higher rates. Moreover, severe need payments do not necessarily go to schools with the largest populations of low-income children. Instead, they are based on the proportion of meals served to low-income children. As a result, schools with a small proportion of low-income students who participate frequently could be eligible if they had low paid participation.

CHILD CARE FOOD PROGRAM

Question: The Administration proposes to eliminate special State audits of Child Care Centers and Family and Group Day Care Homes.

What are the estimated savings of this proposal in Fiscal Year 1988?

Answer: The estimated savings from discontinuing funding for special State audits is $8.6 million in Fiscal Year 1988.

Question: How many child care centers and family and group day care homes were audited in Fiscal Year 1987?

Answer: The agency does not have figures on the number of audits which are conducted at the State level. The audit funds earned by regional office administered programs are used to conduct program specific audits of these institutions and to fund special request audits; 173 such audits are scheduled for Fiscal Year 1987.

Question: Under provisions of current law, what is your estimate of the number of audits to take place in Fiscal Year 1988?

Answer: Since the CCFP is administered in almost all States by State agencies, not the Food and Nutrition Service, we have no information on the number of audits which are conducted at the State level.

Question: If the administration's proposal were adopted, how would these audits be conducted?

Answer: Audit fees are an eligible program cost and may be included as part of the claim for reimbursement. The extent to which audit costs are recovered will vary by institution since total reimbursement may not exceed the established rates.

Question: How does the administration propose to adjust meal payment rates under the Child Care Food Program?

Answer: Lunches in Child Care Centers would be reimbursed at the same rate as meals in the National School Lunch Program. Free lunches would receive $1.29 in cash and 24 cents in commodities. This compares to $1.41 in cash and 11.75 cents in commodities under current law. Institutions would no longer get subsidies for meals served to students from households above 185 percent of poverty. Under current law, they would receive 13.50 cents in cash and 11.75 cents in commodities.

Rates in family day care homes would not be affected by the legislative proposal. However, meals served to students from households above 185 percent of poverty would no longer be reimbursed.

Question: What affect would this have on the number of meals served?

Answer: We don't anticipate that this proposal will have any affect on the number of meals served.

SUMMER FOOD PROGRAM

Question: How would the Administration's proposal to adjust meal payment rates affect the number of meals available to poor children through the summer food program?

Answer: Our proposal would not change the number of meals provided in the summer program. It reduces the rate of sponsor reimbursement to be consistent with the payment policies we use in the other Child Nutrition Programs. Summer sponsors should be able to absorb these costs without affecting service to children, who would continue to get free meals.

Question: How many schools, camps, and other institutions are estimated to participate in the Summer Food Program this year?

Answer: We do not estimate the number of participating institutions, however, we can estimate participants. We estimate that participation will increase slightly. Peak participation in July 1987 should be about 1.6 million.

Question: How many more children will be served by the Summer Food Program based on the two million meal increase submitted in your budget for Fiscal Year 1988?

Answer: We estimate that on a typical day 16,000 more children will be served through the Summer Food Service Program in Fiscal Year 1988 than in Fiscal Year 1987. This estimate is based on meals served in July, the peak month of program participation.

Question: Why is there only an average participation of 1.6 million children in the Summer Food Program when we know that there are 11.5 million children receiving a free or reduced price lunch during the school year under the School Lunch Program?

Answer: There are several reasons why participation in the summer program will likely never reach the same levels as that of the School Lunch Program. First, eligibility for the program is different. The summer program uses geographical eligibility criteria, while the school programs use individual household income. By definition, not all poor households will be covered by geographical criteria that attempt to target funds towards predominantly poor neighborhoods.

Second, during the school year it is much easier to identify the target population because all school age children are required to attend school. In the summer, some may attend school, but the rest are free to pursue whatever activities they wish; only a portion will be at the recreation or school activities sponsored by organizations in the summer program.

There are also areas of the country where summer program coverage is not universal. The Department makes information available to States and localities about the program. However, decisions to participate in the program are local and subject to many considerations, including the short duration of the program and the fact that it is not a year-round activity.

Question: Would allowing private, nonprofit organizations, with good administrative track records to sponsor the Summer Food Program, help to assure that the 10 million children who are eligible but not served will have an opportunity to receive summer meals?

Answer: We do not believe that expanding the types of eligible sponsors is a good idea. The reforms of the 1981 Omnibus Budget Reconciliation Act limited sponsorship to schools, residential camps and government agencies. Private non-profit organizations were excluded because they were a source of major program violations, fraud and significant problems in program integrity. The program has operated very well in the last six years without recurrence of the incidents that caused concern in the early history of the program.

NUTRITION STUDIES AND SURVEYS

Question. The budget request for Fiscal Year 1988 would decrease funding by $385,000 for nutrition studies and surveys. Would you please provide a brief description and status report of ongoing studies as well as the cost associated with each for the hearing record.

Answer. I am providing a description of current studies in the nutrition studies and surveys program area. Each study description identifies project objectives, the estimated completion date, study contractor if applicable, and estimated total costs.

FISCAL YEAR 1987

	Thru FY 1986	FY 1987 EST	FY 1988 EST
Child Nutrition			
Child Care Study -- Abt Associates, Inc. Descriptive study of Child Care Food Program sponsors, providers, and families who participate in the program. A representative national sample is being studied. Completion expected Winter 1988.	$1,011,360	$488,600	$ -0-
Income Verification --ABT Associates, Inc. Current affects and costs of National School Lunch Program income verification requirements including misreporting, are	422,066	781,000	196,934

being examined in a nationally representative sample of school districts. Completion expected Fall 1988.			
Commodity Donation Study --Virginia Tech To continue funding for monitoring School Food Authorities who participated in the study of alternatives to commodity distribution and which P.L. 99-198 authorized to continue to receive cash or letters of credit in lieu of commodities until June 30, 1987.	3,603,120	146,880	-0-
Summer Food Service Program Study --Mathematica Policy Research, Inc. Characteristics of sponsors, sites and meals in the Summer Food Service Program are being described for a nationally representative sample. Completion expected Spring 1987.	687,677	12,323	-0-
Training/Technical Assistance --MDR Associates This funding supports various projects such as the printing and distribution of an FNS recipe guide. Completion expected Spring 1987.	150,000	150,000	-0-
Child Nutrition Analysis/Modeling --Urban Institute Study will develop models of program cost and preparation using data gathered in previous studies and information from the sources such as the Census Bureau. Completion expected Fall 1987.	500,000	-0-	-0-
School Food Purchase Survey --Applied Management Sciences Study provides National estimates of school food purchases, amounts of commodities acquired, and description of food purchase procedures. Completion expected May 1987.	860,000	-0-	-0-
State Commodity Distribution Systems Evaluation --Abel, Daft & Earley, Inc. The major objective of the study is to assess the cost-effectiveness of the various food distribution systems in place. Completion expected Summer 1987.	400,000	-0-	-0-

NUTRITION EDUCATION AND TRAINING PROGRAM
(NET)

Question: The Nutrition Education and Training (NET) Program is designed to provide school food service personnel, teachers and children with nutritional training and management skills.

How is this program integrated with Child Nutrition Programs?

Answer: As the language of the Nutrition Education and Training (NET) Program specifically mandates, integration with the Child Nutrition Programs is central to its operation. The purpose of NET as stated in Section 19 of the Child Nutrition Act as amended November 10, 1977, under Public Law 95-166, is to encourage dissemination of scientifically valid nutrition information and education programs to all children participating in or eligible to participate in school lunch and related Child Nutrition Programs. In most States, the NET Program is administered by the Director of Child Nutrition Programs in the State educational agency which is advantageous in assuring the required integration.

Question: What is the NET Program doing to encourage more efficient and greater nutritional use of donated Federal commodities?

Answer: Activities promoting the use and acceptance of donated Federal commodities are incorporated into NET Program components for students, teachers, and school food service workers. Commodities are made available for teachers and food service workers to use in conducting tasting parties for students. This helps to introduce the students to new foods and increases their acceptance of these foods when they are served in the lunchroom. Efficient uses of commodities are also included in menu planning and food preparation training workshops conducted for school food service workers. In addition, some State NET Programs have collected creative commodity recipes, developed by local school lunch managers, and distributed them State-wide.

PUERTO RICO NUTRITION ASSISTANCE PROGRAM

Question: What is the maximum benefit for a family of four under the Puerto Rico Nutrition Assistance Program? How does this compare to the Food Stamp Program maximum benefit for a family of four?

Answer: Puerto Rico's maximum benefit for a family of four is currently $199 per month although this amount is subject to adjustment, depending upon the availability of funds under the nutrition assistance grant. The Food Stamp Program's maximum benefit for a family of four has been $271 per month since October 1, 1986.

Question: How would the maximum benefit be affected if the nutrition assistance program were reduced to $825 million in Fiscal Year 1988? (Please base your estimate on current inflation and unemployment rates.)

Answer: If the Puerto Rico grant is set at $825 million in Fiscal Year 1988, the Commonwealth may set maximum benefits at the

Fiscal Year 1986 level or effect other program changes to stay within its budget. Administrative costs have remained relatively stable, ranging from $23.4 to $24.6 million per year during Fiscal Years 1983 through 1986. Special projects costs have declined from $21.5 million in Fiscal Year 1983 to $8.6 million in Fiscal Year 1987.

Question: How many households are estimated to participate in the nutrition assistance program during Fiscal Year 1987?

Answer: Average monthly household participation totaled 409,749 in Fiscal Year 1984; 402,556 in Fiscal Year 1985; and 408,254 in Fiscal Year 1986. The Commonwealth's Fiscal Year 1986-1987 plan of operation made no significant alterations which would expand program eligibility to new segments of the Island's population. We, therefore, anticipate that the program caseload will remain fairly stable between 405,000 and 410,000 households in Fiscal Year 1987.

Question: If the block grant were reduced to $825 million in Fiscal Year 1988, how many households would participate in the nutrition assistance program?

Answer: The Commonwealth has maximum flexibility under the nutrition assistance grant to expand or contract program eligibility to targeted segments of the Island's needy population. Any expansion or contraction of the grant amount can, therefore, be accomodated by increasing or restricting eligibility among the Commonwealth's needy and/or raising or lowering benefit amounts for the eligible population. Restriction of the grant amount of $825 million for Fiscal Year 1988 would probably result in a caseload compatible with those recorded for the last three fiscal years (approximately 410,000 households or less).

Question: What is the status of special projects approved under the nutrition assistance program?

Answer: The conference report accompanying the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35) permitted Puerto Rico to use a small proportion of the block grant to finance projects likely to improve or stimulate agriculture food production, and food distribution in order to increase the self-sufficiency and nutritional standards of the Commonwealth's needy population. Four special projects were approved under this authority since inception of the block grant in 1982. Currently, only one special project (the Tick Eradication Program) remains in operation in Puerto Rico for Fiscal Year 1987. This project, funded at $8.6 million for the fiscal year, has been in operation since 1978 and has reportedly been successful in reducing tick infestations among the Commonwealth's beef and dairy cattle herds.

Question: On March 2, you testified before the Senate Finance Subcommittee on Social Security about the Administration's effort to reduce welfare dependency which is embodied in its proposal to allow, within existing programs targeted to the low-income populations, the development of innovative demonstration programs. Would you support an initiative for Puerto Rico utilizing a small portion of the NAP grant to set up a demonstration project that meets the goals of the administration as outlined in your testimony and in the bill, S. 610? If so, in what amount?

Answer: There is no need for any portion of the NAP to be diverted into a demonstration program. S. 610 requires that the needs of the low income population being met by programs included in a demonstration continue to be met by the new demonstration program. The Commonwealth of Puerto Rico currently has virtually complete flexibility in using the funds provided it under the NAP to meet the nutritional needs of its citizens.

Question: Has FNS considered initiating a special employment and training project for Puerto Rico that would enable job registrants to obtain nutrition assistance similar to the Food Stamp Program?

Answer: The Commonwealth has the flexibility to structure its Nutrition Assistance Program to incorporate such an employment and training program subject to Departmental approval. While it has recently considered such an approach, the Commonwealth did not choose to incorporate this concept into its Fiscal Year 1986-1987 plan for operation. The Commonwealth still has the option to do so if it so chooses sometime in the future.

Question: The CBO estimate for current services for Fiscal Year 1988 is $880,000,000. What is your current services estimate?

Answer: The CBO estimate reflects the maximum authorization included in the Food Security Act of 1985. Because Congress has the discretion to appropriate any amount up to the authorization ceiling, the current services level is somewhat dependent on Congressional action. Our current services estimate is $880 million.

COMMODITY SUPPLEMENTAL FOOD PROGRAM

Question: In Fiscal Year 1987, FNS has made substantial increases in the caseload for the Commodity Supplemental Food Program. The total caseload is now over 230,000 women, infants, children, and senior citizens. The Fiscal Year 1988 budget would reduce the funding for the Commodity Supplemental Food Program by $6.9 million. Please tell the committee how you expect that the CSFP sites will absorb these reductions?

Answer: Under our budget proposal, the number of people who could participate in CSFP in Fiscal Year 1988 is higher than the levels attained in Fiscal Year 1986. It is more difficult to assess the changes relative to 1987 participation, since we are still mid-year and CSFP agencies are in the midst of changing participation rapidly.

Question: What sites do you expect will have a reduction in participation?

Answer: It is not clear that there will need to be reductions in participation. We cannot predict this now because the critical issue of unused resources and unused caseload can only be determined at the end of this year. Due to the possibility of unused resources, 1987 participation may be increased in Fiscal Year 1988.

Question: FNS has proposed to reduce the administrative funding for CSFP Program sites from 15 percent to 5 percent. Please provide for the record, the amount that each site currently receives in administrative funds and what each would receive under this legislative proposal.

Answer: Public Law 99-198 requires administrative funding be made available to Commodity Supplemental Food Program (CSFP) State agencies in an amount equal to 15 percent of the sum of (1) the appropriation and (2) the value of additional commodities donated by the Secretary and distributed to participants.

Our legislative proposal retains the base administrative funding rate of 15 percent of the appropriation (see attached Chart #1 for Fiscal Year 1987 base grant levels). It only reduces the adminstrative reimbursement funds for the distribution of donated commodities (see attached Chart #2 for estimated Fiscal Year 1987 administrative reimbursement grant levels and the proposed 5 percent). These administrative reimbursement grant levels are not guaranteed; but must be earned through the distribution of donated commodities to program participants. Adjustments are made to the estimated grant levels based on actual commodity issuance data during the course of the fiscal year.

We cannot predict the administrative reimbursement grant levels for each site for 1988 in advance; but, the estimated grant levels for Fiscal Year 1987 should provide a bench mark for 1988 distribution levels.

Chart #1

COMMODITY SUPPLEMENTAL FOOD PROGRAM

Fiscal Year 1987 Base Grant Levels

STATES SERVING WOMEN, INFANTS AND CHILDREN	TOTAL ANNUAL BASE GRANT
D.C.	$ 192,555
KTY.	159,317
N.C.	48,903
TENN.	789,979
REGION	998,199
ILL.	405,949
MICH.	1,213,602
R.LAKE	14,840
REGION	1,634,391
LA.	656,452

COL.	$495,276
IOWA	90,702
NEB.	156,363
S.D.	59,704
REGION	802,045
ARIZONA	116,332
CALIF.	173,896
REGION	290,228
SUBTOTAL	4,573,870
STATES SERVING ELDERLY	
D.C.	80,468
KTY.	52,552
N.C.	25,225
TENN.	57,471
REGION	135,248
MICH.	690,277
LA.	393,659
COL.	59,447
IOWA	150,153
NEB.	59,447
REGION	269,047
ARIZONA	31,531
CALIF.	50,450
REGION	81,981
SUBTOTAL	1,650,680
GRAND TOTAL	$6,224,550

COMMODITY SUPPLEMENTAL FOOD PROGRAM

Chart #2

	EST. REIMB. GRANTS ALLOCATED/OR TO BE ALLOCATED TO STATES (15 PERCENT OF ACTUAL EARNED VALUE)					PROPOSED 5 PERCENT
	1 QTR.	2 QTR.	3 QTR.	4 QTR.	TOTAL	TOTAL
STATES SERVING WOMEN, INFANTS & CHILDREN						
D.C.	\$13,008	\$19,578	\$19,578	\$19,578	\$71,742	\$23,314
KTY.	21,927	16,463	16,463	16,463	71,316	23,772
N.C.	4,986	5,177	5,177	5,178	20,518	6,839
TENN.	61,026	82,698	82,698	82,697	309,119	103,040
REGION	87,939	104,338	104,338	104,338	400,953	133,651
ILL.	11,898	42,978	42,978	42,977	140,831	46,944
MICH.	161,784	126,061	126,061	126,060	539,966	179,989
R.LAKE	1,302	1,571	1,571	1,571	6,015	2,005
REGION	174,984	170,610	170,610	170,608	686,812	228,937
LA.	64,599	69,498	69,498	69,498	273,093	91,031
COL.	33,756	52,435	52,435	52,434	191,060	63,687
IOWA	12,861	9,602	9,602	9,603	41,668	13,889
NEB.	16,371	16,554	16,554	16,554	66,033	22,011
S.D.	7,341	6,321	6,321	6,320	26,303	8,768
REGION	70,329	84,912	84,912	84,911	325,064	108,355
ARIZ.	NONE	13,649	13,649	13,648	40,946	13,649
CALIF.	15,723	18,410	18,410	18,411	70,954	23,651
REGION	15,723	32,059	32,059	32,059	111,900	37,300
SUBTOTAL	\$426,582	\$480,995	\$480,995	\$480,992	\$1,869,564	\$623,188
STATES SERVING ELDERLY						
D.C.	N/O	18,501	18,501	18,500	55,502	18,501
KTY.	N/O	12,083	12,083	12,082	36,248	12,083
N.C.	N/O	5,800	5,800	5,799	17,399	5,800
TENN.	N/O	13,213	13,213	13,214	39,640	13,213
REGION		31,096	31,096	31,095	93,287	31,096
MICH.	42,156	141,472	141,472	141,471	466,571	155,524
LA.	36,684	80,363	80,363	80,363	277,773	92,591
COL	N/O	13,668	13,668	13,667	41,003	13,668
IOWA	36,732	29,965	29,965	29,964	126,626	42,209
NEB.	N/O	13,668	13,668	13,667	41,003	13,668
REGION	36,732	57,301	57,301	57,298	208,632	69,544
ARIZ.	N/O	7,250	7,250	7,249	21,749	7,250
CALIF.	N/O	11,599	11,599	11,600	34,798	11,599
REGION		18,849	18,849	18,849	56,547	18,849
SUBTOTAL	\$115,572	\$347,582	\$347,582	\$347,576	\$1,158,312	\$386,104
GRAND TOTAL-)	\$542,154	\$828,577	\$828,577	\$828,568	\$3,027,876	\$1,009,292

FOOD STAMPS - GENERAL

Question: Despite an increase in the average benefit per person of $1.91 in Fiscal Year 1988, the projected increase for the Food Stamp Program under current law is modestly reported at $130 million.

Your statement notes that your estimates are based on an unemployment rate of 6.5 percent, as well as an average reduction of 146,000 in average monthly food stamp participation.

Please tell the committee how you have arrived at the 6.5 percent unemployment figure, as well as what your assumptions are about inflation, that affect the participation rate and ultimately the cost of the Food Stamp Program.

Answer: Our budget estimates, as well as those of all other Executive Branch agencies, are based on a consistent set of economic assumptions produced by the Office of Management and Budget and the Council of Economic Advisors.

While participation levels and program costs are affected by economic conditions in general, our forecasts of future caseloads and costs are driven by two key economic indicators--the civilian unemployment rate and the cost of the Thrifty Food Plan. As you noted, we assume that the unemployment rate will average about 6.5 percent in 1988. We also assume that the cost of the Thrifty Food Plan for a family of four will increase by about 3.8 percent.

The combination of higher food stamp benefits and somewhat lower participation is expected to increase the cost of benefits by about $360 million. This increase, however, is partially offset by an increase in anticipated collections of State liabilities for excessive overpayments. The net increase in necessary budget authority is about $130 million.

QUALITY CONTROL

Question: The legislative proposal submitted by the Administration would hold back funds from administrative grants to the States as a means for imposing dollar-for-dollar liability for benefits issued erroneously in excess of five percent. The anticipated savings is estimated at $269 million in Fiscal Year 1988. Combined with other collections efforts, under this proposal, $502 million would be collected from the States in Fiscal year 1988.

Do you believe that, based on historical considerations, this is a realistic estimate?

Answer: We believe that the assumed collections in the President's budget are ambitious but attainable given our commitment to the process.

We do not believe that the amount of money collected to date is a meaningful indicator of future collections. Quality control liabilities are still relatively new, so the Department has attempted to offer States every reasonable opportunity for review and appeal. This process has taken a fair amount of time. We expect that the whole process will move more quickly once this initial set of legal and technical questions is resolved. We are confident that the resolution of these issues will affirm the quality control system.

Question: What is the current trend that State error rates are exhibiting? Are they declining or increasing?

Answer: There has been a reduction in error rates. Since Fiscal Year 1980, the overpayment rate has dropped from about 10 percent to just over 8 percent in Fiscal Year 1985.

EMPLOYMENT AND TRAINING PROGRAM

Question: The Employment and Training Program for food stamp registrants that was mandated by the 1985 Farm Bill is due to go into operation on April 1, 1987. In Fiscal Year 1987, $50 million is available for this program. Will this program be implemented by April 1, 1987?

Answer: Yes, the Employment and Training Program will be implemented on time. All State agencies submitted plans for the first six months of operation in early March, as required. The overwhelming majority will have their plans approved by April 1 and will implement their programs on schedule. We have been pleased with the efforts of most State agencies to establish meaningful Employment and Training Programs.

Question: In its consideration of State plans for Employment and Training Programs, has FNS found that States anticipate spending more than $50 million provided under the Federal grant?

Answer: All States are required to spend money in addition to the $50 million Federal grant, to reimburse participants for necessary and reasonable expenses associated with employment and training requirements, up to $25 per participant per month. In addition, States may receive 50 percent Federal funding for other employment and training costs in excess of the Federal grant. Nineteen States have plans to spend more than their Federal grant for employment program costs other than participant reimbursements.

Question: If so, how much has been requested? Does FNS plan to request more funds for this program in Fiscal Year 1987?

Answer: We are currently reviewing States' plans for employment and training. Nineteen States expect to spend funds over and above the Federal grants authorized for Fiscal Year 1987. These costs are under consideration and final funding requirements will not be known for some time. We have no plans to request additional funds at this time.

ADMINISTRATIVE EXPENSES

Question: Among your legislative proposals is a reduction in Federal funding for States with excessive administrative costs that would save about $2 million in Fiscal Year 1988. Do you have an idea what States will be affected by this proposal?

Answer: Based on Fiscal Year 1985 data on per recipient costs in the Food Stamp Program (FSP), as well as in the AFDC and Medicaid programs, we estimate that potentially only two States would be affected by the FSP limit if they do not implement cost-saving measures. These States are Alaska and Arizona.

This proposal is not designed to achieve large savings or to be punitive to States. The limits are established at levels sufficiently above the normal range of States' costs to affect only States with unreasonably excessive administrative costs. Provisions are included to ensure that States are not penalized for certain expenditures and factors that influence costs which are outside of the State agency's control.

Although few States are affected, the proposed FSP change is an integral component of the Administration's overall proposal to limit Federal administrative costs in the AFDC, Medicaid and Food Stamp Programs, and it should be assessed within this context. Nine States with particularly high costs over all three programs would potentially be affected by the proposals.

ADMINISTRATIVE MATCHING COSTS

Question: Another legislative proposal would reduce the share of funding for special administrative efforts designed for anti-fraud activities and for upgrading or developing computer systems. How will this proposal affect your efforts to encourage increased automation by States in administration of the Food Stamp Program?

Answer: We believe that the advantages offered by automated program management systems will continue to drive States toward computerizing. The enchanced level of Federal cost-sharing will be phased out over two years. However, the Federal Government will continue to fund half of all food stamp automation costs.

Enhanced funding for automation was authorized seven years ago at a time when automation was considered a novelty which States would not pay for without special incentives. Our expectations for office management have changed substantially during the 1980's and computerized food stamp case management systems have become the norm. By mid-1989, 49 State agencies will be fully automated. Accordingly, we believe that it is now time for States to pay the normal 50/50 share for administrative costs.

Question: Is this match proposal consistent with other State administered programs such as AFDC?

Answer: The Department of Health and Human Services is submitting companion legislation to lower the Federal matching rate for automation in AFDC to 75 percent in Fiscal Year 1988 and to 50 percent in October 1990. Also DHHS is proposing to lower Medicaid matching rate to 50 percent at the beginning of Fiscal Year 1988. (Certain AFDC and Medicaid automation costs are now receiving 90 percent Federal cost sharing.)

FINAL CLAIMS FOR STATE ADMINISTRATIVE COSTS

Question: What is the purpose of the administration's proposal to limit the submission of final claims for state administrative costs to 90 days after the close of a fiscal year?

Answer: The same limitation given to us several years ago for the Child Nutrition and Milk Programs has worked well. The major result has been great improvement in the timeliness and accuracy of State reports. We hope for the same result in the Food Stamp Program.

Question: Will this result in any budget savings?

Answer: This proposal, which has no cost saving implications, will greatly improve the timeliness and accuracy of State reports. This is our objective, not to deny legitimate payments. The demand for timely and accurate data concerning State administrative costs from the Congress, general public and various other income security welfare agencies is great.

Question: Is this consistent with other federal programs, such as AFDC?

Answer: This proposal would be consistent with other FNS programs. However, States have two years from the quarter in which costs were incurred for submission of a final claim for State administrative costs under the AFDC program.

JOB TRAINING PARTNERSHIP ACT (JTPA)

Question: The Administration proposes to count JTPA stipends as income under the Food Stamp Program to save $10 million in Fiscal Year 1988. Are JTPA food stamp recipients entitled to earned income deduction?

Answer: The Department is proposing that all payments made under the Job Training Partnership Act (JTPA) be included as income for food stamp purposes except for JTPA payments for reimbursements which would be excluded under another food stamp provision. Under the proposal, JTPA cash payments intended to support general living expenses would be included as unearned income and would not be subject to an earned income deduction. The proposal would also include as income, the JTPA earnings of dependents under 19 years of age, which were excluded under P.L. 99-198, the Food Security Act of 1985. Those earnings, as well as other JTPA earnings already included as income by P.L. 99-198, would be subject to a 20 percent earned income deduction under the proposal.

Question: Does your estimate take this deduction into account?

Answer: Yes, the Department takes the earned income deduction into account as appropriate.

Question: What would be its effect if included in your estimate?

Answer: The effect is included in the Department Estimates.

APPLICATION PROCESSING

Question: Recently, there have been several news accounts that the Food Stamp Applications are not being processed within the 30 days required by law.

Is FNS taking any steps to monitor or correct this situation?

Answer: The Department is aware that the budgetary problems in certain States have required reductions in the resources dedicated to administration of the Food Stamp Program. These States are being closely monitored and have been informed that providing benefits on a timely basis to eligible households is a statutory requirement. FNS' experience is that States are making a concerted effort to comply with the 30-day standard.

Question: What is FNS doing to assure compliance by the States with expedited service to eligible food stamp households in emergency situations?

Answer: The Food and Nutrition Service checks on compliance with expedited service requirements through its Management Evaluation (ME) review process. For Fiscal Years 1986 and 1987, expedited service has been targeted as an ME priority review area for State agencies. Further, all State Commissioners have been notified in writing by FNS of the need to ensure that food stamp applicants who qualify for expedited service are provided benefits within the required timeframes.

SALES TAX

Question: How many States are now in compliance with the prohibition of State and local sales tax on food stamp purchases?

Answer: Twelve. Nine States implemented October 1, 1986, and three had identical prohibitions in effect at that time and were, therefore, automatically in compliance with the Federal prohibition. Four States charge no sales tax on food. The remaining 34 States that are affected by the sales tax provision either have implementation extensions to October 1, 1987, from the Secretary or have statutory authority to implement on the same date.

Question: How many States do you expect to comply by the end of this fiscal year?

Answer: All 34 States which have not yet implemented sales tax prohibition and are affected by it are expected to implement on or before October 1, 1987.

Question: What level of Federal savings do you anticipate in Fiscal Year 1987? In Fiscal Year 1988?

Answer: The sales tax provision in the Food Security Act of 1985 was not intended to generate any Federal savings. Prohibiting State and local taxes on purchases made with food stamps simply increases the purchasing power of food stamp recipients. Households with limited resources can now spend the entire food stamp benefit on food. They no longer have a portion of that benefit diverted to pay sales tax. We estimate that this change increased the effective purchasing power of food stamps by about $120 million a year.

NEEDY FAMILY PROGRAM

Question: The FNS budget reflects a decrease in funding of $3.5 million in Fiscal Year 1988 based on the availability of Commodities purchased in advance of the fiscal year.

Will this offset in any way reduce participation in the program or affect administrative cost?

Answer: We do not expect a decrease to affect partcipation or administrative cost because commodities purchased during the fourth quarter of Fiscal Year 1987 will be delivered to recipients during 1988.

QUESTIONS SUBMITTED BY SENATOR SASSER

INFANT FORMULA REBATES

Question: My state of Tennessee is trying to serve more children under the Women, Infants and Children program (WIC) by stretching the federal WIC dollars. Tennessee is doing this through an innovative program that requires companies to offer rebates on each can of infant formula provided to low income children through the WIC program. However, it has been brought to my attention that the Department of Agriculture is not allowing states like Tennessee to use any of this rebate money for administrative purposes, creating a difficulty in delivery the services. Can you tell me why the Department of Agriculture seems to be placing an obstacle in the way of states like Tennessee which are trying to serve more children with a limited amount of federal WIC dollars?

Answer: States cannot use any portion of infant formula rebates for administrative costs because rebates start as and should remain as food funds. Food grants to States must be used exclusively to buy food for low-income women, infants, and children who are at nutritional risk and cannot be diverted to pay for State administrative expenses.

The intent of rebate systems is to serve more participants with a fixed, food grant. Transferring food funds in the form of infant formula rebates to a State's administrative account would diminish the potential for participation increases. States can meet the additional administrative costs which may result from the desired participation increases through more efficient use of their administrative grants. The Food and Nutrition Service and WIC State agencies have cooperatively developed a major management enhancement program which has as one of its four basic objectives increased efficiency in administrative cost management. Standards of practice have been cooperatively developed in pursuit of this objective. The Department believes that all State agencies can manage more efficiently. Tennessee in particular has significant potential for increasing administrative efficiency. We are not setting up special rules for Tennessee, but are treating it even-handedly in a way consistent with States which have worked to reduce WIC food costs in other ways. These States have not been allowed to divert food funds for administrative expenses. We are aware of broad concerns of not "rewarding" States which are efficient in using food funds and are working to improve this in our administrative funding formula which will base administrative funding on the number of participants.

TEMPORARY EMERGENCY FOOD ASSISTANCE PROGRAM

Question: The Administration has once again requested zero funding for the Temporary Emergency Food Assistance Program (TEFAP). This program is instrumental in providing much needed assistance to low income and elderly individuals, many of whom do not receive adequate food each day. The program also serves as a wise use of many of our surplus commodities which are stored unused in warehouses across America. Congress showed its disapproval of eliminating TEFAP last year by deferring funds of $50 million for the program. Why eliminate the program (TEFAP) when it is providing beneficial assistance to thousands of hungry Americans and helping to reduce government commodity surplus?

Answer: The Administration did not propose to stop distributing surplus food. Commodities will continue to be donated to assist the needy as long as inventories exist. In Fiscal Year 1986 alone, the U.S. Department of Agriculture (USDA) donated nearly 948 million pounds of food worth approximately $846 million.

The Administration did propose to reduce funds for TEFAP State administrative costs in Fiscal Year 1987. This proposal is no longer in effect. However, State agencies should pay the cost of distributing food within the State since USDA funds the entire cost of the food being donated and the cost of delivering the food to the State. We currently provide $50 million for intrastate administrative expenses. States should bear this cost, which is equivalent to 6 percent of the value of the food.

This substantial Federal commitment supplemented by innovative support from State and local resources can ensure continued and effective operation of surplus food distribution. In fact, huge quantities of food were successfully distributed to needy Americans prior to the first provision of Federal funding for State or local administrative costs.

QUESTIONS SUBMITTED BY SENATOR BUMPERS

FOOD STAMP--STATE ADMINISTRATIVE EXPENSES

Question: Your budget proposes reducing the federal share of State expenses. Which States are likely to be affected? Do you propose any exemptions for small or rural States?

Answer: The Administration is proposing limits on the amount of Federal funding for administration of the Food Stamp Program. The objective is to convey to States that the Federal

Government will no longer pay an equal share for costs that are excessive. Although small or rural States are not exempt, we recognize that there are differences in economies of scale among States. Since all States must spend a core amount regardless of program size, a "fixed" cost allowance is deducted from States' costs to adjust for the disproportional effect on unit costs of a small caseload.

This proposal is not designed to achieve large savings or to be punitive to States. The limits are established at levels sufficiently above the normal range of States' costs to affect only States with unreasonably excessive administrative costs. Other provisions are included to ensure that States are not penalized for certain expenditures (e.g., Employment and Training Program costs) and factors that influence costs which are outside of the State agency's control (e.g., different wage levels).

Based on Fiscal Year 1985 data on per recipient costs in the Food Stamp Program (FSP), as well as in the AFDC and Medicaid programs, we estimate that potentially only two States would be affected by the FSP limit if they do not implement cost-saving measures. These States are Alaska and Arizona.

JOB TRAINING PARTNERSHIP ACT

Question: The Administration's budget message proposes to save $10 million by counting JTPA stipends as income to Food Stamp recipients. Since Congress exhaustively considered this issues in 1985 and made some JTPA payments count as income, why are you proposing this?

Answer: We are proposing to include all payments provided under the Job Training Partnership Act (JTPA) as income for food stamp purposes for two reasons.

First, the extent that these payments are not reimbursements excluded as income under another food stamp provision, they represent cash income which is available for the household's use, including the purchase of food. There is no inherent difference between the JTPA payments now excluded as income for food stamp purposes and other income which is fully countable as such. The purpose of the food stamp income determination is to ascertain the household's ability to purchase food using its own resources and, thus, the amount of Federal food assistance the household needs. It is important that this calculation reflect actual household income as accurately as possible.

Second, our proposal to include all JTPA payment as income, rather than only counting certain JTPA earnings, it intended to establish consistent treatment of (1) recipients of different types of JTPA income and (2) JTPA recipients and households with similar total income that do not receive JTPA payments.

Question: If you count these stipends as income, aren't you undermining the ability of stipends to serve as incentive to participate in JTPA?

Answer: We do not believe that individuals would be discouraged from participating in JTPA if all JTPA payments were included as income for purposes of the Food Stamp Program. Since food stamp benefits are reduced 30 cents for each additional $1.00 income, most, if not all, recipients of JTPA payments would still be better off by receiving the JTPA payment and reduced food stamp benefit than if they did not receive the JTPA income at all.

QUALITY CONTROL

Question: The budget message proposes savings in the Quality Control system by holding states liable for every dollar of overissued benefits over a 5% tolerance level and collecting each state's expected liability from its FY 88 administrative grant. Does it make any sense to propose drastic changes in the Quality Control system when we are still awaiting the results of a study of quality control being prepared by the National Academy of Sciences at the request of Congress?

Answer: We believe there is no reason to delay our proposal to base cost sharing for Food Stamp Program overissuance errors on benefits rather than administrative costs. The drawbacks to the current assessment against administrative costs are too great.

The first problem with basing liabilities on administrative costs is that the amount of liabilities are unrelated to the cost of overissuance. Second, the way liabilities are assessed is another factor that causes States that are nearly similar in error to face very different costs. For example, a State with an error rate of 8.1 percent faces much higher liabilities than a State with an error rate of 7.9 percent although their errors are quite similar. The Food and Nutrition Service has recognized these problems for several years and the American Public Welfare Association supported basing cost sharing on benefits in their January 1987 Quality Control Proposal. I fully expect that, whatever their other recommendations the National Academy of Sciences will criticize assessing cost sharing against State administrative costs.

Question: What is the status of the Department's own quality control study?

Answer: The Department's quality control study is well underway and will be submitted on May 12, 1987, when due. In addition to undertaking a review of existing information on the quality control system, we have been able to undertake a substantial amount of new work. This includes an analysis of factors in the observed differences in AFDC and FSP error rates, an analysis of the effects of environmental and caseload characteristics on error, and an additional evaluation of the statistical system underlying quality control. I believe you will find our study both interesting and useful as you consider quality control policy.

ERROR RATES

Question: What trends are the States' error rates currently exhibiting? Are they going up or down?

Answer: We have seen substantial reductions in State error rates since the first half of Fiscal Year 1980, when the overpayment error rate was over 10 percent. In 1985, the error rate was just over 8 percent. We expect that this trend will continue.

Question: What is going on in error rate collections?

Answer: States became liable for Food Stamp Quality Control errors beginning with the April 1, 1981 to September 1, 1981 review period. From that time, through Fiscal Year 1984, the States potential liability has totaled $136,206,434. To date, FNS has collected $990,868. The vast majority of the potential billings ($97,630,285) are either under appeal before the courts, the Department's State Food Stamp Appeals Board, or pending good cause waiver decisions by FNS. The remainder have been waived by either the Agency or the State Food Stamp Appeals Board.

Question: Has USDA done any analysis of how the imposition of quality control sanctions is affecting states' underissuance rates?

Answer: Yes, USDA has analyzed the relationship between overpayment and underpayment error rates. Liabilities for errors are determined by the level of a State's overpayment (overissuance to eligible households plus payments to ineligible households) error rate. Our analysis has focused on the relationship between overpayment and underpayment error rates to ensure that overpayment is a good proxy for overall accuracy. The evidence indicates that it is a good proxy.

Our analysis indicates that underissuance has remained low and stable for several years at about 2-1/2 percent. Moreover, reducing overpayment error does not lead to increased underpayments. Overpayment and underpayment error rate changes have tended to move together, with either increases or decreases in both rates. It seems that error in general is a more consistent problem for States than the possibility of shifting error from overpayments and underpayments. Also States with high overpayments tend to have high underpayments. Likewise, those States that achieve low overissuance error rates also tend to achieve low underissuance error rates.

STATE AUTOMATION

Question: FNS recently published new regulations requiring the States to adopt model Automated Data Processing plans by October; at a time when you are encouraging increased automation, what sense does it make to reduce Federal matching funds?

Answer: The Department is proposing to gradually reduce the enhanced Federal funding currently available to State agencies for their costs for planning, designing, developing, or installing automated data processing (ADP) systems. Under this proposal, 75 percent Federal funding would be provided through March 31, 1988; 70 percent funding from April 1 - September 1988; 65 percent funding from October 1, 1988 - March 31, 1989; 60 percent from April 1--September 30, 1989; 55 percent from October 1, 1989--March 31, 1990; and 50 percent beginning April 1, 1990. The proposed two-year phase-out period will provide State agencies the opportunity to complete ADP start-up activities while Federal funding at an enhanced rate is still available.

We are offering this proposal because State agency automation has progressed admirably and the bulk of automation is completed. Only one State agency has made little progress in automation. Forty-nine State agencies have or will have by mid-1989 automated certification systems that perform eligibility and/or benefit determinations as well as other case management functions. The remaining State agencies include local offices serving large metropolitan areas that are supported by partially --or fully--automated systems.

Questions Submitted by Senator Harkin

ADMINISTRATOR'S PHILOSPHY

Question: In as much as you are new to this position, would you please provide us your personal philosophy concerning the goals, objectives, and administration of the programs under your jurisdiction.

Answer: The goal of the programs of the Food and Nutrition Service is to provide access to a more nutritious diet for low-income persons and strengthen America's agricultural economy through the distribution of commodities. I am wholeheartedly in sympathy with those goals and objectives. In my view, public concern for the poor and public attempts to ameliorate their lives are appropriate and necessary.

As a conservative on economic issues, of course, I am concerned about the economic inefficiencies of income redistribution. I am fully aware, however, that transfers to the poor are but a small part of total government transfers, and frankly, of all transfers, they are the least troubling to me on economic grounds.

I have, however, been critical of the effectiveness of certain aspects of our programs of assistance to the poor, including nutrition programs. Is the welfare system that we have in place really the best that we can do for the poor? I think there is broad agreement across the political spectrum that it is not, even though there may be disagreement on what should be done. But I would like to reassure the Congress that I am pragmatic in this regard, as well as conservative. I believe in conserving what exists unless change is a clear improvement in terms of assisting more efficiently those who have come to depend on the system that we have collectively created, or enabling them to become independent. And, of course, accountability to the tax-payers is an integral part of the public trust.

In my capacity as Acting Administrator, I would like to administer the programs under my jurisdiction as effectively as possible, according to the intent of the laws which created those programs, while safeguarding program integrity. I would be in favor of changes in those programs, however, which would make them more effective in alleviating poverty and in simplifying the lives of the poor.

FOOD STAMP CASH OUT

Question: How do you feel about cashing out the Food Stamp Program?

Answer: I am not opposed in principle to cashing out food stamps, provided that it were done in a welfare reform context and did not threaten the ability of the poor to achieve nutritionally adequate diets. It seems to me that what is important is not the name of the program, but whether what we are doing best addresses the needs of the target population in the most rational and cost-effective way.

FOOD STAMP UNDERISSUANCE

Question: The Budget Message highlights the need for controlling the over-issuance of benefits. I am concerned about the lack of balance in this message. What about the under-issuance of benefits? In October of 1986, the GAO issued a report entitled "Restoration of Improperly Denied or Terminated Benefits." This report states that Illinois improperly denied or terminated food stamp benefits for 23% of the cases studied. In reviewing the State's procedures, GAO found that the State made no effort to restore benefits to eligible persons that were improperly terminated from the program and that FNS was not even aware that this problem existed.

Isn't this contrary to your own regulations?

Answer: In cases where it is determined through Quality Control (QC) reviews that a household was improperly denied or terminated and was entitled to receive or continue to receive benefits, the case is required to be returned to the State agency for appropriate action. Current regulations require that the State agency certify a household if it is currently eligible or compute the coupon allotment for restoration of lost benefits for a household erroneously terminated from the program.

It should be noted that the QC negative action case review alluded to here is a procedural review, and does not include a determination of whether the household lost benefits. The percentage of households that are entitled to restored benefits is, therefore, lower than the nominal error rate. In each case, however, the State is to follow-up and restore benefits if appropriate.

Question: What kind of program do you have in place to guard against this type of problem?

Answer: The QC review system is used to monitor State agencies' compliance with requirements that improperly denied or terminated households are either certified or provided with restored benefits when appropriate. The Illinois State agency has instituted corrective action and now has a system in place which adheres to program regulations. All State agencies have been advised by FNS that current regulations concerning restoration of lost benefits to eligible households must be complied with and monitored closely. This area has also been targeted as a priority review area for Fiscal Year 1987 as part of the Management Evaluation process.

Question: What have your internal audit studies shown concerning this problem? Please submit for the record any studies, analyses, or other documentation concerning this problem.

Answer: At this time, FNS is reviewing States through the Management Evaluation process. This area is being closely monitored this year and any deficiencies found in States' operations will be corrected.

Question: Has FNS followed up on the GAO study on a regional basis? What do your preliminary results show?

Answer: Each FNS regional office has been provided with a copy of the GAO study and advised that the monitoring of State agencies' performance in this area is a priority. Furthermore, all State Commissioners have been notified by FNS, in writing, of the need to ensure full compliance with requirements governing restoration of incorrectly denied or terminated benefits. Approximately 21 State agencies have responded to FNS' letter and all have stressed their commitment to provide timely and accurate benefits to all eligible households.

Question: I think you should take your quality control program for overissuance back until you have completed your studies, GAO has completed its studies, and the National Academy of Sciences has completed its study and then come back to your standing committee (the Nutrition and Investigations Subcommittee) with your comprehensive quality control program for some appropriate Congressional input, review, and oversight. Will you do this?

Answer: We realize that there are studies being conducted concerning the quality control (QC) system. There may be changes to QC which result from these studies. We believe, though, that however the system is affected, once it is established how errors are to be determined and what threshold of errors should exist for State agencies, there will still be the need for a system to assess State agencies' fiscal responsibility for their errors in excess of the threshold. To that end, we believe the Department's proposal to amend the error rate liability system is rational, equitable and appropriate for consideration by Congress at this time. Therefore, we do not intend to withdraw it pending completion and analysis or the currently onging studies.

HNIS--NUTRITION MONITORING IMPROVEMENTS

Question: The report, "Nutrition Monitoring in the United States" was issued last July. Your agency was a significant contributor to this publication. Its recommendations include (1) improved methods and techniques for gathering information for assessing nutritional status and (2) increased resources for the National Nutrition Monitoring System. How does this budget address these needs and how far does it take us in achieving the recommendations of this report?

Answer: Four recommendations regarding "improved methods and techniques for gathering information for assessing nutritional status" were made in the report, and HNIS has been and is active in all four areas. Two of these recommendations--to study factors influencing food intake and to improve coverage of minority and low-income populations--are specifically addressed by the continuous data collection proposed in this budget. Dietary intake data collection from 37,000 individuals over the 1989 to 1995 period from the general and low-income populations will permit the analyzing and reporting of data on dietary status, an important predictor and component of nutritional status. The third recommendation--to evaluate the feasibility of developing indicators for monitoring dietary changes--has been addressed by funding a National Academy of Sciences study to recommend standards for improving the interpretation of data on dietary intakes. In addition, HNIS has recently funded cooperative agreements with two universities to study an important aspect of the correct use of such standards--the inter- and intravariability of intakes by individuals. The fourth recommendation--to improve methods for assessing dietary intake--is addressed by HNIS' ongoing methodological research group which conducts and oversees research to improve methods for sampling the population and for collecting, processing, analyzing, and reporting data on dietary status. Inhouse literature reviews, extramural investigations funded by HNIS, conferences, workshops, and additional statistical analyses have provided a basis for introducing in NFCS 1987 and in CSFII 1989, questions on new factors that may influence diets and their impact on nutrition and health. HNIS recently funded cooperative agreements with three universities to study the methods used in collecting dietary data. The results of these studies will be available prior to the CSFII 1989.

The budget request, along with actions already underway or planned, meets a significant part of the recommendations of the Joint Nutrition Evaluation Committee. The requested budget increase for a continuing survey directly addresses recommendations number 3, 5, 6, 7, 8, 9, 10, and 12 in the report "Nutrition Monitoring in the United States."

WIC PROGRAM

Question: Please provide for the record what the subsequent social costs are of ignoring the nutritional needs of the economically disadvataged and other nutritionally poor classes of individuals participating in WIC?

Answer: The nutritional needs of the poor are not being ignored. The Department of Agriculture provides $20 billion per year in food assistance. Through the Food Stamp Program, $10 billion provides for purchasing power to buy more adequate diet for the lower income population. WIC provides $1.6 billion per year in additional benefits targeted towards those high risk women, infants and children with nutritional risk conditions. It has never been the policy of the administration to ignore the nutritional needs of the economically disadvantaged. Rather we have worked toward better targeting of assistance programs to the needy.

NUTRITION MONITORING

Question: In this report you identify certain high dietary consumption items that require priority monitoring such as cholesterol, sodium, and alcohol. How does your current program help to resolve these problems? Are you recommending or can you recommend "more appropriate approaches" to dealing with these concerns as called for in your charter?

Answer: The current program helps to resolve these problems in two ways:

(1) The Dietary Guidelines for Americans published jointly by the USDA and the DHHS recommends that people avoid too much cholesterol and sodium and, if they drink alcoholic beverages, to do so in moderation. HNIS has distributed, free through the Consumer Information Service, copies of the bulletin presenting the Guide lines since 1985 and sponsored other promotional activities. Also, HNIS has developed nutrition education materials for use along with the Guidelines. These materials provide specific guidance to help people to know how to put the Guidelines into practice.

(2) HNIS believes that dietary guidance relating to specific dietary concerns should be designed with an understanding of actual food consumption patterns. In its CSFII or 1985-86 and NFCS-1987 questionnaires, HNIS has increased the information obtained on fat, cholesterol, sodium, and alcohol by asking more questions about fat and salt added in cooking and at the table and by increasing the probes on fat, cholesterol, salt, and alcohol. These methods improve the quality of the information on dietary levels of these components and the understanding by educators of the food consumption and eating practices associated with high and low intakes.

The use of results from the CSFII provides an example of how HNIS recommends dealing with these concerns, and how HNIS uses the survey data in making policy-relevant decisions on nutrition education materials and programs.

Proportions of women with average intake for 4 days from CSFII 1985 that achieved specified fat, cholesterol, and sodium levels were determined. Few women met levels recommended by some authoritative groups.

Fat: Of the women reporting 4 days of food intake, only 12 percent ate fat furnishing the less than 30 percent of calories suggested by some authorities, such as the National Cancer Institute and the American Heart Association (AHA). But these low-fat diets were also lower in other important nutrients. The mean levels of calcium, iron, and zinc in these lower fat diets were below levels for women who had higher fat diets. Only 10 percent of the women reported 4-day diets with saturated fat below 10 percent of calories, as AHA suggests. These women also had mean intakes of iron and zinc that were especially low.

Cholesterol: The 300 milligrams or less of cholesterol suggested by AHA in 1978 was achieved in 62 percent of the women's 4-day diets. However, the more recent recommendation of less than 100 milligrams of cholesterol per 1,000 calories was achieved by only 9 percent of the women. Those who achieved this goal had intakes especially low in essential minerals.

From these findings, it appears that achievement of these recommended fat and cholesterol levels would require major dietary change. Furthermore, such change could easily result in diets with reduced levels of essential nutrients unless extensive educational efforts are made to promote food choices that provided needed nutrients while reducing fat and cholesterol. Programs recommending the use of these stringent levels of fat and cholesterol to the general population--which has limited knowledge on how to choose nutritious diets--could have adverse, rather than positive, effects on the overall quality of American diets. At a minimum, the public needs clear, practical food selection guidance to help them to improve nutrient levels while avoiding too much fat and cholesterol in their diets. Studies are under way to illustrate dietary changes that might be required to meet various goals suggested.

Question: Your report mentions alcohol as an item of concern. Please explain how your program addresses this issue. How about tobacco? Does it fit into your program?

Answer: Both the CSFII 1989 to 1995 and the NFCS 1987 include questions on the intakes of alcohol (grams and the proportion of individuals using). NFCS 1987 includes additional questions on the frequency of using alcohol. Both surveys include questions on cigarette smoking. The alcohol and the tobacco questions have been designed to link with NHANES. In addition, the Dietary Guidelines for Americans recommends that Americans who drink alcoholic beverages should do so in moderation.

Alcohol either displaces other foods/beverages or is consumed in addition to them. Since alcohol contributes calories and dilutes nutrient density, it is important to know the degree of impact. Smokers have been identified as consuming alcoholic beverages more frequently than nonsmokers. If part of the calories come from alcohol, dietary intervention and assistance need to take this into account.

SAINT AMBROSE COLLEGE

Question: I received a copy of a directive from the FNS regional office (attached) announcing a change in eligibility requirements for sponsors participating in the Summer Food Service

Program (SFSP). This change states that private institutions sponsoring nonresidential programs such as St. Ambrose College's summer program for economically disadvantaged children can no longer receive benefits. However, the same program, if it were at a public university, or if it were a residential program, would continue to receive benefits. Are you familiar with these program changes? Are you familiar with the program at St. Ambrose College? How were you able to terminate a sponsor's participation after 7-8 years without a statutory change just because it isn't a public institution? Does this mean that private institutions cannot use the SFSP to help needy and disadvantaged children? What is the legal basis for this change? Did USDA's General Counsel review these program changes? Please provide for the record the opinion of USDA's General Counsel and other statutory authority that permits your regulatory or procedural change in this program.

Answer: Prior to the enactment of the Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35), nonresidential public or private nonprofit institutions such as St. Ambrose College were eligible to participate in the SFSP. However, that legislation changed the type of entities eligible to participate as sponsors in the SFSP. This provision of law was effective October 1, 1981 and implementing regulations were approved by the Department of Agriculture's Office of the General Counsel and then published on February 16, 1982. The law and regulations specify that service institutions eligible to sponsor the program include: public or private non-profit school food authorities (must be of high school grade or under); public or private nonprofit residential summer camps; and units of local, municipal, county, or State government. Therefore, a number of private institutions do continue to participate as sponsors. However, they are limited by type. In addition, State colleges and universities meeting the eligibility requirements may participate as government sponsors but must directly operate the program and accept final financial and administrative responsibility for program operations at sites. We understand that St. Ambrose College inappropriately participated in the program over the past five summer sessions. We further understand that the summer sites served by St. Ambrose College in Davenport, Iowa, will be sponsored by the Davenport Board of Education for this coming summer.

(The letter and directive follow:)

LETTER FROM LYLE WILHARM, CONSULTANT, BUREAU OF FOOD AND NUTRITION

Agreement No. 82-9983

January 21, 1986

Edward Henkhaus, V.P. Finance
St. Ambrose College
518 West Locust Street
Davenport, Iowa 52803

Dear Edward:

A memo from the USDA Mountain Plains Regional Office, Denver, Colorado is attached. The memo addresses the subject of eligible sponsors for the Summer Food Service Program for Children.

Please note that "Private colleges and universities cannot be considered entities of government and cannot therefore be a sponsor unless they can meet eligibility as a nonprofit private residential summer camp".

Since the St. Ambrose program is not residential, this regulation eliminates St. Ambrose as an eligible sponsor for the SFSPC. We appreciate that you have sponsored this program for the past several years, however, we are forced to solicit new sponsorship.

I will conduct a final close-out audit within the next several weeks to be scheduled at a pre-determined date.

Sincerely,

Lyle Wilharm, Consultant
Bureau of Food and Nutrition

DIRECTIVE FROM FORREST R. MOORE, REGIONAL DIRECTOR, SPECIAL NUTRITION PROGRAMS

Eligible Summer Food Service Program (SFSP) Sponsors

STATE AGENCY DIRECTORS - Colorado, Iowa, Kansas, Montana OPI, Nebraska,
(Special Nutrition Programs) North Dakota, South Dakota, Utah, and Wyoming DHSS

There have been questions regarding colleges and/or universities fitting into the definition of an eligible sponsor for the SFSP. Types of sponsors eligible to participate as specified in 225.18 of the regulations are:

(1) public or nonprofit private school food authorities;

(2) public or nonprofit private residential summer camps; and

(3) units of local, municipal, county, or State governments.

For the purpose of the SFSP, public colleges and universities are considered entities of government. Private colleges and universities cannot be considered entities of government and cannot therefore be a sponsor unless they can meet eligibility as a nonprofit private residential summer camp.

If you have any questions regarding this matter, please let me know.

FORREST R. MOORE
Regional Director
Special Nutrition Programs

QUESTIONS SUBMITTED BY SENATOR McCLURE

EXCESS ERROR SANCTIONS

Question: The overwhelming majority of the "savings" proposed for FY88 represent collections of fiscal sanctions imposed on States for high rates of erroneous benefit payments--sanctions already assessed, those soon to be assessed based on past and current performance and future assessments. Some $233 million in sanctions for erroneous payments prior to FY88 are assumed to be collected in FY88. What were the collection rates in the past five years? Based upon this record what changes do you foresee which will allow you to increase the collection rate of these assessments? What is the Administration's expectations as to the level of errors most States could effectively achieve in 1988?

Answer: State liabilities for excessive overpayments were first assessed for performance between October 1980 and March 1981. To date, we have collected $990,868. The balance of the potential liabilities is under appeal.

We do not believe that the amount of money collected to date is a meaningful indicator of future collections. Quality control liabilities are still relatively new and the Department has offered States every reasonable opportunity for review and appeal. This process has taken a fair amount of time. We expect that the whole process will move more quickly once this initial set of legal and technical questions is resolved.

We believe the resolution of these issues will affirm our confidence in the quality control system. In response to a Congressional mandate in the Food Security Act of 1985, the Department has undertaken an intensive review of the quality control system as the basis for withholding Federal funds from States with excessive errors and as the source of management information to improve the accuracy of eligibility and benefit determinations. We plan to submit the results of this study to Congress this spring.

For the purpose of our budget submission, we have assumed that States will continue to take the corrective actions necessary to achieve further error reductions. By 1988, we have assumed that the national average overpayment error rate will be 7.4 percent. Of course, many States may do better than average and others may do worse.

COMMODITIES

Question: On page 32g-5 of the USDA's 1988 Budget explanatory notes for the Committee on Appropriations, Vol. 2, there is a breakdown of the value of commodities for FY86. It states that the FNS purchased $101.4 million in meat, poultry, fish, fruits and vegetables, grains, oils and peanut products. Could you please provide me with a breakdown of these purchases by commodity by State? In other words, where were the various commodities purchased? In addition, please include the Section 32 purchases by commodity and State.

Answer: FNS maintains records of purchases by each appropriation account on a national basis only. These are the figures that were provided on page 32g-5 of the 1988 Budget explanatory notes.

Question: The National Commodity Processing (NCP) Program has over 25,000 recipient agencies registered to participate in the NCP Program but only 50 percent are actively participating in the program. Where are these agencies located, which are actively participating and why are only 50 percent participating. There are only about 60 processors approved to sell end products to eligible recipients. What is FNS doing to promote more processors to participate in NCP and to encourage participation by more processors?

Answer: Of the recipient agencies actively participating in the NCP program, 64 percent are concentrated in two geographical areas, i.e., the Midwest Region (49 percent) and the Mountain Plains Region (15 percent). Many of the States in these regions have discontinued their statewide bonus processing contracts since NCP Program was implemented in 1983.

Why a low percentage of registered recipient agencies actively participate in the NCP Program. First, 40 percent (approximately 10,000) of registered recipient agencies are categorized as non-school types (e.g. Charitable Institutions, Child Care Food Programs, Elderly Nutrition Programs, Correc-tional Institutions, Summer Food Service Program/Camps). However, non-school recipient agencies traditionally purchase relatively small quantities of NCP products. Most processors therefore target public and private schools to market their products because the sales potential is significantly greater. For example, schools represent approximately 89 percent of the total number of active recipient agencies, while only 11 percent are nonschools. With flour now available for distribution under the NCP Program, we expect more processors to apply for participation in the program.

QUESTIONS SUBMITTED BY SENATOR KASTEN

SPECIAL MILK PROGRAM

Question: Secretary Bode, welcome. My first question concerns the Special Milk Program, through which the Agriculture Department provides half-pints of milk to children in schools that do not participate in other Federal nutrition programs.

I supported a provision in the Child Nutrition Amendments of 1986 making the Special Milk Program available to kindergartens. I firmly believe the Program has a role to play in encouraging healthly nutrition habits in young children -- indeed, I see that as its primary role.

In other words, unlike the School Lunch Program, Special Milk is as much an education as a nutrition program. Yet USDA is proposing to effectively gut this program by making children with family incomes above 130% of poverty ineligible.

How can you justify this? The Federal subsidy in this program saves families above the poverty line perhaps a few pennies -- but that misses the whole point of the program.

I believe it is very important to encourage good eating habits, starting with the youngest children. The Special Milk Program is one small way we can do this. So I would say to you that I will not support, and I do not believe this committee will support the administration's proposal in this area.

Answer: I completely agree with you that the subsidy only saves families above the poverty line a few pennies--and that is the point of our proposal. The families with income above 130 percent of the poverty level can afford to pay an additional 9 cents per half-pint and we believe they will. This proposal should have no significant effect on the number of half-pints served in schools. It will merely require those families who can pay for milk to do so.

TEMPORARY EMERGENCY FOOD ASSISTANCE PROGRAM

Question: There has been some concern expressed in Wisconsin that not everyone eligible to receive surplus cheese and other commodities through TEFAP (NOTE: Temporary Emergency Food Assistance Program) is in fact receiving them.

What is the problem? Is the Department low on commodities? Are the problems in administration and distribution, getting the commodities where they are needed?

Answer: USDA allocates commodities to States based on the number of unemployed persons and persons living below poverty within the State. This process ensures that the excess commodities available are distributed among States in an equitable manner.

States are responsible for establishing household eligibility criteria and seeing that commodities are distributed to local distribution sites. Wisconsin has established eligibility for TEFAP at 150 percent of poverty. If eligible participants are not being served, the State needs to examine its distribution system to see if adjustments are needed.

Question: Finally, could you summarize the commercial displacement issue?

Answer: USDA is required to consider the effect on commercial markets whenever a commodity is distributed. The Temporary Emergency Food Assistance Act (TEFAA) of 1983, the legislation authorizing TEFAP, has specific language directing the Secretary of Agriculture not to make commodities available in any quantity that the Secretary determines may substitute for the same or any other agricultural produce that would otherwise be purchased in the market. TEFAA also requires the Secretary to report annually to Congress as to whether displacement is occurring due to TEFAP donations.

In a report presented to Congress in July 1986, USDA found that for every pound of cheese donated over the life of TEFAP, commercial American cheese sales declined by four-tenths of a pound. Each pound of butter donated caused margarine sales to decline by eight-tenths of a pound. Butter donations displace margarine because the low-income households which receive TEFAP commodities do not normally purchase butter.

Displacement has a significant impact on commercial markets. Displacement caused by cheese was equivalent to 8 percent of total American cheese sales in 1985. Butter donations displaced margarine sales equivalent to 4 percent of the total market in the same year.

Displacement has significant implications for the Federal budget as well. Because USDA must purchase all dairy products that are offered at the support price, cheese donations through TEFAP increased Federal expenditures by $230 million. This is equivalent to the value of cheese that USDA had to purchase because it could not be sold through commercial channels.

After considering the impact of donations on commercial markets and the Federal budget and weighing these concerns with the needs of low-income Americans, USDA decided to continue distributing cheese and butter through TEFAP at the level of 35 and 6 million pounds per month respectively.

SURPLUS MILK

Question: With the whole-herd buyout and declining dairy support prices, there is a smaller milk surplus now than there was a few years ago. What is the Department's estimate of the amount of surplus dairy products that will be available this year to distribute to the needy through TEFAP and other programs?

Will the supply be adequate to maintain these programs at the levels we have seen in the recent past?

Answer: The Agriculture Stabilization and Conservation Service (ASCS) advises that bonus dairy products will be available to traditional outlets during School Year 1988 in approximately the same quantities that were available this year. Requirements are expected to be around 105 million pounds of butter, 110 million pounds of process cheese, 60 million pounds of chedder and 40 million pounds of nonfat dry milk.

For TEFAP, distribution of dairy products for the fourth quarter Fiscal Year 1987 has been authorized at the same monthly levels as now provided. The monthly authorization is 35 million pounds of process cheese, 6 million pounds of butter and 8 million pounds of nonfat dry milk. The levels in Fiscal Year 1988 have not yet been determined.

HUMAN NUTRITION INFORMATION SERVICE

QUESTIONS SUBMITTED BY SENATOR BURDICK

CONTINUING SURVEY OF FOOD INTAKES BY INDIVIDUALS

Question: The Fiscal Year 1988 budget request for HNIS includes an increase of $1.5 million for the Continuing Survey of Food Intakes by Individuals. The Department justifies this increase by stating that data that has been evaluated from 1985 and 1986 would be compared to the decennial Nationwide Food Consumption Survey. Why would HNIS compare data from the intake survey with the Nationwide Food Consumption Survey that is almost ten years old?

Answer: The 1985 Continuing Survey of Food Intakes by Individuals (CSFII) data were compared with data collected in 1977 because they are the most recent comparable data available. The 1985 CSFII data will also be compared with the data now being collected in the Nationwide Food Consumption Survey (NFCS) 1987. Comparisons such as these provide information on changes in the dietary status of the population.

One purpose of the continuous data collection during the CSFII planned for 1989 to 1995 is the establishment of a moving average for food and nutrient intakes that will permit the Department to follow trends on the dietary status of the population on a yearly, and therefore, more timely basis than has been possible with the decennial surveys. This moving-average approach was recommended by two committees established by the Food and Nutrition Board of the National Academy of Sciences as a way to provide timely data in a cost-efficient manner. The CSFII data collection will be unique in this respect.

Question: Isn't a new Nationwide Food Consumption Survey about to get underway?

Answer: The new Nationwide Food Consumption Survey (NFCS) started on April 1, 1987. Data collection will continue through March 1988. Over the past several years, USDA has redesigned its food consumption survey operations. Included in the new design are a scaled down decennial survey (NFCS 1987) and a modified Continuing Survey of Food Intakes by Individuals (CSFII 1989-95). The combination of these surveys is less costly and provides population coverage on a more timely basis than did the single NFCS.

Question: Would it not make more sense to compare the intake survey data with results from the 1987-88 food consumption survey?

Answer: Yes, that is what is intended.

Question: Is this comparison of information the sole purpose for the $1.5 million increase?

Answer: Comparison of new dietary data with past surveys is only one purpose of the continuing survey. Our request for an increase of $1,500,000 for reinstating the Continuing Survey of Food Intakes by Individuals (CSFII) is based on a need for continuous data on the diets of the general population and subpopulations who may be at high nutritional risk. This need is documented in recommendations made in three recent studies:

(a) The President's Task Force on Food Assistance, in its report of January 18, 1984, found it very difficult to draw valid conclusions about dietary needs of the poor because the only data available were old. They made a number of recommendations about steps that should be taken to improve information on the dietary status of the American population. Data from the CSFII satisfies many of these recommendations.

(b) In 1981, the Food and Nutrition Board (FNB) of the National Academy of Sciences, in a study for the Food and Drug Administration, recommended a continuing individual intake survey similar to that which USDA has initiated.

(c) In 1983, an FNB committee reviewed the ways in which national survey data on food consumption are used, identified data most needed by users, and recommended ways to meet those needs. One of their major recommendations was that USDA redesign its individual intake survey to provide continuous monitoring of the population through the use of a moving-average approach.

The ability to track and forecast nutritional problems on a continuous basis is increasingly important as Americans respond to shifts in variables that affect diet, such as employment, family makeup, income, and perceptions about diet/health relationships. This survey will provide policymakers with research-based information on food consumption and dietary adequacy needed to formulate policies for food and nutrition intervention programs, consumer education, food fortification, and regulatory activities.

Although some major uses of the CSFII are the same as those for the NFCS, which collects data on both household use of food and individual food intakes, data from CSFII will be uniquely useful because they are on a continuous, current basis, rather than a "snapshot" every decade. Consequently, trends and changes can be monitored through time to help identify and predict dietary problems and improvements of importance to a variety of users. In addition to USDA needs for the data, regulatory agencies, such as the Food and Drug Administration and the Environmental Protection Agency, will find the data especially useful in their rule-making efforts. Food processing technology and the kinds of foods available change rapidly. Without current estimates of food consumption, it is impossible to estimate the contribution of a specific trace component from food products over time. Neither of these agencies conduct indepth surveys of dietary intake patterns.

COORDINATION OF SURVEYS

Question: The Nationwide Food Consumption Survey is conducted every ten years and provides a national sample of nutritional information based on dietary recall, food frequency, and food accessibility. The National Health and Nutrition Examination Survey (commonly called HANES) will begin in 1987 and collect data on dietary recall, biochemical and physical exams, and other medical information. Although these surveys are conducted by two separate agencies, HNIS of USDA and the National Center for Health Statistics at HHS, they have many features in common. Both represent major undertakings in terms of professional and financial resources on the part of the government. Please tell the committee what steps have been taken to integrate these surveys. For example, how many questions on the food consumption survey will be designed to link with information collected on the upcoming HANES survey?

Answer: NFCS and NHANES are designed to meet the needs of their respective Departments, USDA and DHHS. The two surveys differ in major emphasis: NFCS is concerned with food consumption and food money management by households and food intakes and eating practices at home and away from home by individual household members. Three-day diets by respondents are assessed for nutrient content, and dietary and socioeconomic factors associated with diet quality are determined as the basis for policy decisions about USDA's food assistance and nutrition education programs. NHANES is concerned primarily with assessing the nutritional health status of the population through physical examinations of survey participants, and a single day's dietary data is a small part of that survey. The two surveys also differ in design: NFCS respondents are interviewed in households within 1 year, while NHANES respondents are examined and diet interviews conducted in trailers that move from place to place over several years.

One of the goals of the National Nutrition Monitoring System is to improve comparability between the 3-day NFCS and CSFII surveys and the 1-day NHANES surveys. Both USDA and DHHS have been and are working toward this goal. Staffs of the two Departments have been and are meeting on a regular basis to obtain the greatest possible comparability in the definitions of variables and questions asked about dietary, socioeconomic, and demographic information. As a result, 25 questions are exactly the same. In addition, plans are being worked on to utilize the same sex/age groups in reporting results.

USDA surveys go into greater depth on questions about participation in nutrition intervention programs such as the Food Stamp, School Lunch, and School Breakfast Programs than do DHHS surveys, while DHHS surveys put more emphasis on health-related questions, such as cigarette-smoking and exercise. Even where there is different emphasis, the questions are so worded to provide links between the two surveys for comparison. Some variables occur in only one survey.

Question: Will both of these surveys have basic nutritional questions in common, such as what vitamin and mineral supplements individuals are taking?

Answer: Both surveys contain common questions. Included in these are specific questions on food intakes, and other questions such as general health status, reported height and weight, exercise, lactation, breastfeeding, cigarette-smoking, alcohol intake frequency, and what vitamin and mineral supplements individuals are taking. In addition, both surveys will evaluate information on food intake using nutrient data from the USDA's National Nutrient Data Bank. The use of a common nutrient data base will improve comparability between the surveys.

Question: Is the questionnaire for the food consumption survey in final form?

Answer: The questionnaire for NFCS 1987 has been finalized and has received Office of Management and Budget (OMB) approval. Data collection begins in April 1987.

Question: Why will the continuing survey of food intake be in the field at the same time as the HANES III survey? Won't these two surveys be asking for similar information?

Answer: The Continuing Survey of Food Intakes by Individuals (CSFII) was designed to respond to recommendations made by the National Academy of Sciences and others. The purpose of the recommendation was to improve the knowledge basis for policy decisions involving dietary status. NHANES III is scheduled to be in the field from 1988 to 1994. CSFII is planned for 1989-1996. So there is some temporal overlap. Although some of the information provided by the surveys is similar, the CSFII will provide more complete dietary data more frequently than will NHANES.

The 1-day dietary data in NHANES is useful to show the respondent's food intake the day before the physical examination and for estimating mean nutrient intakes by population segments. However, it is not sufficient for use in estimating the proportion of intakes that fall below the Recommended Dietary Allowances (RDA) or other standards. Research indicates that data on individual food intakes for at least 3 days are needed to assess dietary status relative to standards such as the RDA. Both the NFCS 1987 and the CSFII 1989, with their greater emphasis on food consumption, include the collection of 3 days of intake data.

The collection of multiple days of data in the CSFII is useful for a variety of other purposes, none of which can be met by the NHANES 1-day data:

- To estimate or indicate an individual's typical dietary intake;
- To determine intraindividual variation--that is, how food intakes (and nutrient intakes) vary over several days for one individual;
- To estimate the prevalence of individuals with diets that fail to meet nutritional standards and what food intakes are associated with such "low quality" diets;
- To examine, for individuals, the use of infrequently consumed foods; and
- To examine the range of "usual" intakes of specific nutrients.

Some other advantages to USDA of the CSFII relative to the NHANES are as follows:

- Timely release of data--the first data from the CSFII 1985 and 1986 were published 6 months after completion of data collection; data from CSFII (1989 to 1995) will be published yearly. NHANES III will be initiated in 1988 and will cover two 3-year periods. Because of the way the NHANES samples are drawn and data are collected, the earliest NHANES national report will not be available for 4-5 years following initiation of the survey.

o Seasonal data--available from NFCS/CSFII but not available from NHANES.

o Extensive information on program participation and eligibility (Food Stamp, School Lunch, WIC, etc).

o A separate national sample of low-income households and individuals in CSFII--not available from NHANES.

o Flexibility and responsiveness--because the CSFII will be fielded on an annual basis, special population groups such as the low-income elderly can be included as needed.

Question: Although the continuing survey and HANES III share a common methodological core related to nutrition monitoring, HANES III is a much larger sample, enabling information, such as race, to be drawn out of the data.

Answer: Over the period 1988-1995, NHANES III will provide a slightly larger sample (45,000 individuals) than will the proposed CSFII (37,000 individuals). Data on race will be available from both surveys. However, the moving-average approach planned with the CSFII means that CSFII data on race will be available every year beginning in 1990. In contrast, data collection for blacks in the first NHANES 3-year sample will not be completed until 1991, and the information will not likely be available until sometime after this.

In addition to information by race, the CSFII is designed to provide data every year on the low-income population and to provide, periodically, national samples for groups at nutritional risk such as low-income elderly and teenagers.

Question: Why would not HNIS recommend providing support to the dietary portion of HANES III, rather than conducting a separate continuing survey of food intakes with a much smaller sample of individuals?

Answer: The Department does not recommend that HNIS provide support to DHHS's NHANES III rather than conducting the CSFII because:

1. The NHANES data do not meet the needs of the Department.

2. CSFII provides continuous data for trend analyses.

3. The CSFII sample is almost as large as the NHANES, and the CSFII will provide data by race and income on a yearly basis beginning in 1990. In addition, the CSFII is designed to be flexible enough to provide national samples of specific population groups as the need arises and to be able to add/delete each year specific issue-related questions. In contrast, once the 6-year NHANES is fielded, flexibility in sampling additional population groups will be limited.

4. The CSFII data can be provided on a timely basis, as demonstrated by CSFII 1985 and 1986.

HNIS already provides support for the NHANES through the food coding and Nutrient Data Bank System. We have offered to assist NHANES in collecting some of their additional dietary data.

GENERAL

Question: What survey work is currently in progress that would give information about the number of persons who are nutritionally at risk and are eligible for food assistance, such as WIC or Food Stamps?

Answer: Both the CSFII 1986 which is nearing completion and NFCS 1987 which begins in April 1987, provide information about those individuals who have diets that may indicate they are at nutritional risk. These surveys also provide information about those who participate in the food assistance programs such as Food Stamps, WIC, School Breakfast and Lunch, and about others who have incomes that would cause them to be eligible. Since the surveys are nationally representative samples, the numbers of respondents participating in WIC and School Breakfast Programs are relatively small.

Question: What plans does HNIS have in Fiscal Year 1987 and 1988 for providing scientific and technical assistance, training and consultation on nutrition monitoring to state and local governments? What level of funds will be used for these purposes?

Answer: HNIS provides assistance, training, and consultation to university staff, public health nutritionists, and others through a variety of workshops:

In October 1986, HNIS staff provided a 3-day workshop on the use of CSFII data for staff of seven universities. HNIS has plans to conduct similar workshops in 1987 and in 1988 on using the NFCS data.

A workshop is planned for June 1987 where HNIS staff will work with State public health nutritionists on State nutritional monitoring needs. HNIS has offered to use NFCS 1987 data to develop State data on a limited number of food and nutrient intake items to be identified by an organization of public health nutrition directors.

HNIS is now providing a session at the Nutrient Data Bank Conference on the use of the CSFII. This is an annual nationwide conference of over 200 nutrient and food consumption data users from academia, food industry, and government, at all levels.

Funding for these activities comes out of general appropriations to the agency. Primary costs are associated with staff salaries and travel.

Question: The Joint Nutrition Monitoring Evaluation Committee made a number of recommendations for improvement of national nutrition surveillance. Please respond to each of the following by informing the Committee of your efforts in these areas: (1) Improved coverage of minority, low-income and homeless populations in national nutrition surveys or special surveys; (2) Providing resources for policy-relevance of existing data; and (3) Establishing a mechanism for learning more about the data needs of users, especially Federal Agencies.

Answer: The efforts of the Human Nutrition Information Service (HNIS) to improve national nutrition surveillance in the aforementioned areas are as follows:

(1) Both the NFCS 1987 and the proposed CSFII 1989 include low-income samples. The samples for both are sufficiently large to provide estimates for blacks, but not of other minority groups. HNIS plans to include a proposed low-income elderly survey in 1990.

(2) Congress has established the USDA as the lead agency of the Federal Government for human nutrition research except with respect to the biomedical aspects of nutrition research concerned with diagnosis for treatment of disease--Farm Security Act of 1985, Title XIV. A main purpose of HNIS survey activities is to provide information relevant to Federal agriculture and nutrition policies. The surveys are used to describe the adequacy and safety of U.S. diets and to determine the nature of problems that may exist. Major population subgroups for which problems exist--low-income, elderly, infants, etc.--are identified and remedial strategies, such as programs to provide food assistance or nutrition education, are undertaken.

The CSFII results have been useful to USDA and others in formulating and justifying policies relating to food production and marketing, food assistance programs, and dietary guidance. Some examples follow:

o Dramatic moves away from eating meat since 1977, especially in high-income households, emphasized the need for meat producers and marketers, who customarily link demand with price, to develop and market meat products that are more acceptable.

o Appropriate targeting of the Food Stamp Program was shown: Households receiving food stamps were found to be clearly more "needy" than households eligible for but not receiving food stamps; despite their lower income, individuals from food stamp households fared as well or better nutritionally.

o 1985 data on 4-day dietary intakes of cholesterol and sodium indicate that relatively few individuals meet quantitative goals for these dietary components proposed recently by a professional group. Those individuals who did meet the goals had intakes low in essential minerals. Federal policies and nutrition education materials should be designed to move toward goals for all dietary components, while taking actual intake practices into account.

Food intake and food price data from NFCS 1977-78 formed the research basis for the 1983 revision of the Thrifty Food Plan--the legal standard for benefits in the Food Stamp Program. A computerized model was used to form the food plan which minimized deviation from food consumption patterns of low-income households from the survey while meeting nutritional specifications at given costs. Another study from NFCS researched the effect of the addition of iron and B-vitamins through enrichment and fortification of grain products. Data from the NFCS 1987 will be used to continue these types of studies.

HNIS has funded policy-relevant studies using the data from NFCS 1977-78 and CSFII 1985 and 1986. These include studies of the association of participation in the Food Stamp Program (University of Missouri) and participation in the School Lunch and School Breakfast Programs (North Carolina University) with the quality of diets for use in policy considerations for the food assistance programs.

(3) In 1983, the Department initiated a study by the Food and Nutrition Board of the National Academy of Sciences to review the uses of the Nationwide Food Consumption Survey and make recommendations to facilitate wider application of the resulting data. A majority of the recommendations have been implemented.

In planning for NFCS 1987, all Federal agencies, as well as over 300 individuals from academia and industry, were contacted as to their data needs. This was later followed up by sending each of them a draft copy of the NFCS questionnaires for their comment and suggestion.

In addition, HNIS survey planners have helped plan and participated in a number of workshops with public health nutritionists, regional research meetings, professional meetings, and Nutrient Data Bank Conferences where input was solicited relative to users' needs. We plan to follow the same procedure in developing the questionnaires for the proposed CSFII.

Information on uses and needs for data on dietary and nutritional status by Federal agencies will be compiled and reviewed by the newly formed Subcommittee on Nutrition Monitoring of the Interagency Committee on Human Nutrition Research. As data needs are identified, the collective agencies will develop plans for the most effective ways to provide the data. These may include special surveys of hard-to-reach groups and use of followup surveys.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

BIENNIAL BUDGET CYCLE

Question: Would your department/agency favor a biennial budget process? What benefits would your agency achieve in a two-year appropriation cycle?

Answer: The Human Nutrition Information Service (HNIS) does favor a biennial budget process. A two-year appropriation cycle would provide the agency opportunities for greater emphasis on planning and conducting nutritional and dietary intake assessment surveys of all Americans, thus spending less time on managing budgetary activities that do not fluctuate annually.

Question: Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer: More than 80 percent of HNIS budget preparation activities are relatively predictable from year to year.

Question: What difficulties can you foresee in preparing and submitting a two-year budget to Congress?

Answer: HNIS does not anticipate a great deal of difficulty in preparing a two-year budget because the agency conducts a long-range analysis of funding needs in connection with the current budget.

SUBCOMMITTEE RECESS

Senator BURDICK. This will conclude today's hearing. I appreciate your having been here today to share your concern with us over the fiscal year 1988 appropriation to the Department of Agriculture.

Our next hearing is to be held this Thursday, March 19, at 10, in room SD–124. At that time, we will hear from representatives from the Agricultural Marketing Service, Federal Grain Inspection Service, and the Food Safety and Inspection Service.

Until then, the committee stands in recess.

[Whereupon, at 11:50 a.m., Tuesday, March 17, the subcommittee was recessed, to reconvene at 10 a.m., Thursday, March 19.]

AGRICULTURE, RURAL DEVELOPMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 1988

THURSDAY, MARCH 19, 1987

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:12 a.m., in room SD–124, Dirksen Senate Office Building, Hon. Quentin N. Burdick (chairman) presiding.

Present: Senators Burdick, Sasser, Cochran, and Grassley.

DEPARTMENT OF AGRICULTURE

STATEMENT OF KENNETH A. GILLES, ASSISTANT SECRETARY FOR MARKETING AND INSPECTION SERVICES

ACCOMPANIED BY STEPHEN B. DEWHURST, BUDGET OFFICER

AGRICULTURAL MARKETING SERVICE

STATEMENT OF J. PATRICK BOYLE, ADMINISTRATOR

ACCOMPANIED BY:
- WILLIAM T. MANLEY, DEPUTY ADMINISTRATOR, PROGRAM OPERATIONS
- EDDIE F. KIMBRELL, DEPUTY ADMINISTRATOR, COMMODITY SERVICES
- JOSEPH A. ROEDER, DIRECTOR, FINANCIAL MANAGEMENT DIVISION

OPENING REMARKS

Senator BURDICK. Good morning, ladies and gentlemen.

Today, we are continuing our hearing on the fiscal year 1988 budget for the Department of Agriculture. Specifically, we will hear from the representatives of the Agricultural Marketing Service, the Federal Grain Inspection Service, and the Food Safety and Inspection Service.

With us here today are, Assistant Secretary for Marketing and Inspection Services, Dr. Kenneth Gilles, who hails from that great state of North Dakota—Fargo, ND; Administrator of the Agricultural Marketing Service, J. Patrick Boyle; Administrator of the Federal Grain Inspection Service, W. Kirk Miller; Administrator of the Food Safety and Inspection Service, Dr. Donald L. Houston; and, of course, the able budget officer for the Department, Mr. Steve Dewhurst.

The Agricultural Marketing Service is charged with enhancing the marketing and distribution of agricultural products throughout the country. Its annually appropriated budget for fiscal year 1988 is $33,081,000, a $1.2 million increase over fiscal year 1987.

The Federal Grain Inspection Service is primarily responsible for establishing and implementing uniform standards for U.S. grain and for inspecting and weighing grain that moves through commerce. Its budget request is for an appropriation of $7,122,000, which is an increase over the fiscal year 1987 level of $425,000.

Both the Agricultural Marketing Service and the Federal Grain Inspection Service have considerable funds at their disposal from fees collected.

The Food Safety and Inspection Service is responsible for the inspection of meat and poultry in both processing and slaughtering and is charged with insuring the safety of these meat and poultry products. The FSIS budget for the fiscal year is $397,130,000, an increase of $35,730,000 over fiscal year 1987.

All three of these agencies are also requesting changes in legislation which would provide for user fees, that would fund the agencies at basically 100 percent. I am pleased that you have submitted budgets based on current law, because the legislative changes are not under this committee's jurisdiction.

With that, I would like to tell you that your full statements will be made a part of the record and, if you wish, you may summarize them to the extent you feel is necessary.

Now, I will recognize the gentleman from Fargo, Dr. Gilles.

ASSISTANT SECRETARY'S REMARKS

Dr. GILLES. Thank you. It is a pleasure to appear before the senior Senator from North Dakota, and the most illustrious son of Munich, ND.

It is my pleasure to represent the Department today, sir, and to present to your committee the three major agencies, whose mission is to facilitate the orderly marketing of grain, fruits, vegetables, meat, and poultry products.

By assuring a high level of consumer acceptance and continued marketability of producers' food products, the public, I believe, is well served by these three service agencies.

Two of the administrators who appear before you today, are new in their positions, and the third, Dr. Don Houston, who is the Administrator of the Food Safety and Inspection Service, has been in that position, and served very well, for a number of years.

The first participant is J. Patrick Boyle, the Administrator of the Agricultural Marketing Service. Mr. Boyle has been on the Hill, and prior to coming to the Department, worked closely with Senator Pete Wilson.

The second participant will be Kirk Miller, who is the new Administrator of the Federal Grain Inspection Service, Mr. Miller has come to us, previously, as the president of the American Malt and Barley Association.

At this time, I would like to turn the hearing over to Mr. Boyle.

STATEMENT OF MR. BOYLE

Mr. Boyle. Thank you very much, Mr. Gilles.

Thank you, Mr. Chairman. It is a pleasure for me to have the chance to appear before the committee this morning. As you suggested, I will be happy to summarize the written statement that we have submitted for the record.

1985 FOOD SECURITY ACT

I believe that you and your colleagues on this committee are thoroughly familiar with the programs traditionally administered by AMS. However, the 1985 Food Security Act significantly broadened the responsibilities of our agency.

These new responsibilities include implementing the beef, pork, and watermelon research and promotion programs; initiating a dairy assessment program and purchasing 400 million pounds of red meat in conjunction with the dairy termination program; modifying provisions for milk marketing orders; establishing a commission to review the dairy price support program; certifying that imported tobacco is free from pesticides banned within the United States; and inspecting Canadian potatoes entering through U.S. ports of entry.

We believe that we have done a good job in implementing these new programs, Mr. Chairman, and our written statement discusses in greater detail our progress in each of these new areas.

BUDGET PROPOSAL

Over the past several years, we have successfully transferred a large percentage of our costs from the public to the private sector. This year, our budget proposal identifies additional activities which are currently supported through the annual appropriation process, but could be charged to industry and other identifiable recipients of our services.

LEGISLATIVE PROPOSALS

However, nearly all of the proposed changes and resultant savings are contingent upon passage of user fee legislation which the Department forwarded to Congress in early February.

For the most part, passage of the proposals would leave our programs intact since the majority of the proposals merely would transfer the funding source from an appropriated basis to a user-fee basis.

If our legislative proposals are enacted into law, no appropriated funds would be necessary for our marketing services programs. Further, our request for section 32 administrative expenses would be reduced to $3.1 million.

The major legislative changes we are seeking this year would result in a $15.4 million reduction in appropriations for the market news program, a $9.5 million reduction for egg products inspection, a $4.5 million reduction in appropriations for commodity standards, a reduction of $245,000 for the Plant Variety Protection Act, a $1 million reduction in appropriations for the Federal Seed Act, a reduction of $1.6 million for the wholesale market development program, and a $7.7 million reduction for the administration of the marketing agreements and orders program.

CURRENT LAW BUDGET PROPOSALS

Passage of these proposals will result in the agency being 98 percent user fee supported. If our legislation is not enacted, however, our fiscal year 1988 current law requirements for our marketing services programs is $33.1 million.

In addition, approximately $10.8 million would be required from section 32 to support our commodity procurement program and to administer our marketing agreements and orders program.

The overall appropriated funding level for fiscal year 1988, under current law, would reflect an increase of $1.2 million from the fiscal year 1987 current estimate. The details of this change are explained in the submitted testimony.

PREPARED STATEMENT

Mr. Chairman, this completes the summary of my written statement, and at an appropriate time, I would be more than happy to answer any questions that you may have. Thank you.

Senator BURDICK. Thank you.

[The statement follows:]

STATEMENT OF J. PATRICK BOYLE

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you to discuss the programs of the Agricultural Marketing Service (AMS) and our fiscal year 1988 budget proposal. Let me first introduce my colleagues. They are; William Manley, Deputy Administrator, Marketing Programs; Eddie Kimbrell, Deputy Administrator, Commodity Services; and Joseph Roeder, Director, Financial Management Division.

Mr. Chairman, I have been with the Agricultural Marketing Service (AMS) a short time, having been appointed Administrator in November of last year. I have had several opportunities in the past, however, to work closely with AMS personnel and those industries serviced by the Agency's programs.

Those experiences taught me the important role AMS plays in improving the marketing of agricultural products. Since becoming Administrator of AMS, I have developed a greater appreciation for the impact AMS programs have on the thousands of people who rely on its services to move agricultural products quickly and efficiently through the marketing chain.

Through a variety of programs, AMS is instrumental in fostering a more efficient and competitive marketplace, enhancing producer returns and assuring that consumers receive the quality of products they expect. AMS programs include the establishment of standards and the grading of agricultural commodities, the compilation and dissemination of pertinent market information, inspection services to assure that only wholesome egg products are available for consumption, administration of marketing agreements and orders, purchase of surplus commodities, enforcement of numerous regulatory programs, and applied marketing research.

NEW RESPONSIBILITIES

Mr. Chairman, I believe you and members of the committee are thoroughly familiar with the programs traditionally administered by AMS. However, the 1985 Food Security Act significantly broadened the responsibilities of our Agency and I wish to highlight briefly our work on these programs.

These programs include: implementing the Beef, Pork, and Watermelon Research and Promotion programs; initiating a dairy assessment program and purchasing 400 million pounds of red meat in conjunction with the Dairy Termination Program; modifying provisions of milk marketing orders; establishing a commission to review the dairy price support program; certifying that imported tobacco is free from pesticides banned within the U.S.; and inspecting Canadian potatoes entering through U.S. ports of entry. We believe that we have done a good job implementing these new programs, Mr. Chairman, and I would like to discuss briefly our progress.

Over the past year we have worked closely with the beef and pork industries to implement research and promotion programs within the time frames prescribed by Congress. We reviewed the industry's proposals, published proposed orders, solicited comments on the proposals, and issued final orders in July and September for beef and pork, respectively. All research and promotion efforts, as well as our administrative oversight costs, are being funded through industry assessments on domestically produced and imported products. We also have established an arrangement whereby the U.S. Customs Service will collect assessments from importers of beef and pork.

Comparable to our efforts on beef and pork, another order was issued in July 1986, which authorized a honey research and promotion program. Arrangements similar to those we have established with the Customs Service for beef and pork also have been established for the collection of assessments on imported honey products.

The third research and promotion program authorized by the Food Security Act is for watermelons. An industry proposal was received recently and hearings on the proposal now are being conducted. Administratively, several procedures still must be accomplished before a final decision and potential order are published. We expect that the entire process and final decision will be reached within the next twelve months.

The Food Security Act authorized the whole herd buyout program to reduce milk production. In conjunction with this effort, the Act also authorized that assessments be levied on all milk marketed commercially within the U.S., and the purchase of 400 million pounds of red meat to minimize the adverse effect of the buyout program on livestock producers. AMS has assumed the lead role in implementing these corollary programs. By the end of September 1987, we expect to collect approximately $720 million from dairy producers and remit the funds to the Commodity Credit Corporation to help finance the cost of the buyout program. Similarly, by the end of September, we will have contracted for and purchased the entire 400 million pounds of red meat. The Foreign Agricultural Service and the Food and Nutrition Service have been responsible for distributing this product to foreign and domestic markets. Our combined efforts on the purchase and distribution of this product have helped minimize the effects of increased cow slaughter under the buyout program.

The Food Security Act also affected Federal Milk marketing orders. Statutory increases in fluid milk price differentials were implemented in 35 orders.

The Act also authorized the Secretary to reimburse dairy cooperatives and handlers that provide marketwide services benefiting all producers, if such payments would effectuate the purposes of the marketing order act. Late last year, the Department conducted an extensive hearing on an industry-submitted proposal to permit marketwide service payments in seven southeastern milk marketing orders. A decision on the proposal is pending.

AMS also was instrumental in helping to establish the National Commission on Dairy Policy which was authorized by the Food Security Act. This Commission is presently studying the current dairy price support program, developing alternatives, and will be making recommendations concerning future operation of the program.

To comply with the Food Security Act, AMS issued regulations requiring that tobacco being imported into the U.S. be certified free from prohibited pesticides. Samples from imported tobacco are being drawn and sent to AMS and APHIS laboratories for verification.

In compliance with the Food Security Act, we also are monitoring the importation of Canadian potatoes entering through northeastern ports of entry. Through random spot checks, we have reduced the volume of substandard Canadian potatoes entering the U.S.

BUDGET PROPOSAL

Mr. Chairman, I would now like to address the specifics of our fiscal year 1988 budget proposal. Over the past several years, we have successfully transferred a large percentage of our costs from the public to the private sector. This year, our budget proposal identifies additional activities which are currently supported through the annual appropriation process, but could be charged to industry and other identifiable recipients of our services.

However, nearly all of the proposed changes and resultant savings are contingent upon passage of user fee legislation. Each of the legislative proposals already has been forwarded to the Hill for consideration and we actively are seeking sponsorship for introduction and subsequent passage of the proposals. For the most part, passage of the proposals would leave our programs intact since the majority of the proposals merely would transfer the funding source for the activities from an appropriated basis to user fees.

If our legislative proposals are enacted into law, no appropriated funds would be necessary for our marketing services programs. Further, our request for Section 32 administrative expenses would be reduced to $3.1 million.

The major legislative changes which we are seeking would result in:

— A $15.4 million reduction in appropriations for the Market News Program. Legislation will be proposed which will allow user fees to be charged to recover the entire cost of collecting, analyzing, and disseminating market news information;

— A $9.5 million reduction in appropriations for Egg Products Inspection. The proposed legislation will allow user fee assessments to recover the full cost of the program;

— A $4.5 million reduction in appropriations for Commodity Standards. Legislation will be proposed to enable fees to be charged for the costs associated with developing, reviewing, or modifying standards used in the grading programs;

— A $.2 million reduction in appropriations for the Plant Variety Protection Act. The proposed legislation would allow the funds collected for this program to be retained for use by AMS to support the program;

-- A $1.0 million reduction in appropriations for the Federal Seed Program. Proposed legislation would allow AMS to recover the Federal regulatory costs through the licensing of interstate shippers of seed;

-- A $1.6 million reduction in appropriations for the Wholesale Market Development Program. Proposed legislation would allow user fees to be charged to recipients requesting assistance in planning improved wholesale food facilities and in developing new technologies aimed at finding ways to improve food distribution; and

-- A $7.7 million reduction in appropriations for the Administration of the Marketing Agreements and Orders Program. Proposed legislation would allow AMS administrative costs to be recovered through an assessment on regulated handlers.

Passage of these proposals will result in the Agency being 98% user fee supported.

CURRENT LAW

If our proposed legislation is not enacted, our fiscal year 1988 current law requirements for our marketing services programs is $33.1 million. In addition, approximately $10.8 million would be required from Section 32 to support our commodity procurement program and to administer our marketing agreements and orders program. The overall appropriated funding level for fiscal year 1988, under current law, would reflect an increase of $1.2 million from the fiscal year 1987 current estimate. These increases are necessary to offset increased operating costs associated with our existing programs.

The specifics of the current law proposals include:

— An increase of $2.5 million to fund the FY 1987 pay cost increase, offset increased operating costs, and fund the New Federal Employee Retirement System.

— A decrease of $.4 million to reduce federal expenditures to help meet the deficit mandate.

— A decrease of $.9 million for the elimination of the Payments to States Program.

Mr. Chairman, at this point, I would be glad to answer any questions that you have regarding our program activities or proposed budget.

FEDERAL GRAIN INSPECTION SERVICE

STATEMENT OF W. KIRK MILLER, ADMINISTRATOR

ACCOMPANIED BY:

DAVID R. GALLIART, DEPUTY ADMINISTRATOR

ROBERT "E" SODERSTROM, DIRECTOR, RESOURCES MANAGEMENT DIVISION

BUDGET REQUEST

Senator BURDICK. Who is next?

Mr. MILLER. Good morning, Mr. Chairman. Thank you for the opportunity to present the fiscal year 1988 budget for the Federal Grain Inspection Service. To conserve the committee's time, I would like to submit our written statement for the record, and to present a summary statement this morning.

Under current law, we are requesting $44 million for fiscal year 1988. User fee funding for inspection and weighing activities totals $36.9 million, while our appropriation request totals $7.1 million for standardization, compliance, international monitoring, and advisory committee activities.

No new program funding is requested. The executive budget proposes user fee legislation, which, if enacted, would convert the $7.1 million appropriation request to user fees.

During the past fiscal year, FGIS has continued to tailor its programs to meet fluctuating demands for inspection and weighing services. Despite agency cost reduction measures amounting to $2.2 million, or a 6-percent reduction from the total cost, an 18-percent decrease in grain exports resulted in a negative operating margin of $2.1 million in fiscal year 1986. This comes at a time when FGIS is striving to maintain self-sufficiency in its user fee supported inspection and weighing program.

Further, the negative margin created a balance in the revolving fund that was less than the desired 3 month operating reserve we wish to maintain. We, therefore, chose not to retire the remaining $2 million of the $6 million supplemental appropriation we received in November 1983. We have always considered this supplemental appropriation to be a line of credit to be used only when necessary, and we expect to retire the balance when operating balances permit.

The executive budget for fiscal year 1988 will expand user fee funding to include standardization, compliance, international monitoring, and advisory committee activities. Although the general public receives some benefit from these activities, the direct beneficiaries are those who participate in the marketing of U.S. grains and related commodities.

It is appropriate that the costs for these activities be borne by the identifiable groups who benefit from these activities. The increased user fees will be assessed on the basis of the cost of the service.

The increased public attention given to the problems with export grain quality and the 18-percent decline in U.S. grain exports during fiscal year 1986 led to enactment of legislation to improve the quality of U.S. grains. The U.S. Grain Standards Act was amended on November 10, 1986, with the enactment of the Grain Quality Improvement Act of 1986.

To carry out the requirements of the new law, especially enforcement of the prohibition against recombining or adding dockage or foreign material to grain, will require more personnel and, therefore, involve additional costs. The unbudgeted costs associated with implementation of the provisions of the new law is cause for concern.

Items featured in the unabridged statement, but not presented in this brief opening, include program and financial information, grain elevator safety, FGIS advisory committee activities, and issues of concern such as wheat classing and insect infestation.

PREPARED STATEMENT

This concludes my testimony, Mr. Chairman. Again, I too will be happy to respond to questions at the appropriate time.

Senator BURDICK. Thank you.

[The statement follows:]

STATEMENT OF W. KIRK MILLER

I appreciate the opportunity to appear before this Committee today. My presentation will include a description of the overall Federal Grain Inspection Service (FGIS) program, and emphasize our continued efforts to provide a cost effective grain inspection and weighing service.

We anticipate a total operating level of $44.0 million for fiscal year 1988. Under current law, user fees will account for $36.9 million and will fund our inspection and weighing activities. For standardization and compliance as well as foreign monitoring and advisory committee activities, our appropriations request totals $7.1 million. However, the Administration will submit user fee legislation which, if enacted, would convert the $7.1 million appropriations request to user fees.

The FGIS' mission is to provide for the establishment of official U.S. standards for grain, to promote the uniform application of standards by official inspection personnel, to provide for an official inspection system for grain, to regulate the weighing and certification of the weight of grain shipped in interstate or foreign commerce and to carry out the delegated responsibilities under the Agricultural Marketing Act of 1946. These activities are funded mostly by a user fee cost recovery program. The inspection and weighing activities, which are mandatory at export ports and permissive in the domestic area, comprise the national "Official" inspection and weighing system.

This system encompasses approximately 4200 employees, 766 of whom are FGIS field personnel who provide the direct, on line inspection and weighing of grain at 61 export elevators and the supervision of licensees at domestic markets. Eight delegated States employing 664 employees provide official services at an additional 30 export elevators under direct Federal oversight. In the domestic market, permissive inspection and weighing services at inland locations are performed under Federal monitoring by approximately 2100 licensed inspectors, weighers, samplers and technicians employed by 80 designated State and private agencies.

Currently, FGIS derives approximately 84 percent of its revenues from user fees charged for its inspection and weighing services. Revenues received are related to requests for our services which in turn depend on the volume of grain exports. Reduced grain exports continued throughout fiscal year 1986. Despite cost containment efforts, such as employee furloughs, the fund experienced a large loss for fiscal year 1986. This loss reversed a pattern of operating profits for fiscal years 1984 and 1985. Because of this loss, the $2.0 million balance of a $6 million supplemental appropriation FGIS received in November of 1983 will be repaid in fiscal year 1987 if operating balances permit. We have always considered this supplemental appropriation to be a line of credit to be used if needed.

Grain export inspections totaled 82.8 million metric tons, compared to last year's 101.1 million metric tons, a decrease of 18.3 million metric tons or 18 percent. Domestic grain inspections totaled 164.8 million metric tons, compared to last year's 168.0 million metric tons, a decrease of 3.2 million metric tons or 2 percent.

FGIS' user fee revenues during fiscal year 1986 were $27.5 million, with obligations of $29.6 million, yielding a negative operating margin of $2.1 million. Prior year adjustments of $640,000 accrued to the revolving fund which ended the year at $6.7 million. The $6.7 million is slightly below the 3-month operating reserve that we strive to maintain. Revolving fund obligations for fiscal year 1986 were $29.6 million or approximately $1.9 million below last year's level of $31.5 million.

Because of decreased exports and cost containment efforts, total obligations were below budget authorization limits. Fiscal year 1986 appropriated obligations of approximately $6.4 million plus revolving fund obligations of $29.6 million totaled $36.0 million or approximately $2.2 million under fiscal year 1985 total program obligations.

Effective January 5, 1987, FGIS increased fees by 17 to 42 percent for official inspection and weighing services. FGIS continued to reduce staffing levels, furlough employees, and take other cost-saving measures in an effort to provide cost-effective services without endangering its ability to respond to the grain industry's need for quality service. The fee increases will cover operating costs and, in addition, will gradually replenish applicable operating reserves to 3-month levels.

PROPOSED LEGISLATION

The Administration will propose user fee legislation beginning in fiscal year 1988, for standardization, compliance, foreign monitoring, and advisory committee activities. Then user fees will fund 100 percent of the Agency's programs. This legislation is a continuation of the Administration's efforts to reduce the Federal deficit and decrease our dependence on appropriated funds. Although the general public receives some benefit from these standardization and compliance activities, the direct beneficiaries are the producers, merchandisers, users and others who participate in the marketing of U.S. grains and related commodities. User fees will be based on the costs of the service provided.

We recognize that this proposal may cause some consternation within the grain and related commodities industries. Moreover, the FGIS Advisory Committee has opposed this concept. However, the industry has benefited from and supported our previous and continued efforts to provide a cost effective service. FGIS' dependence on user fee funding has increased from 59 percent in fiscal year 1981 to approximately 84 percent in fiscal years 1982 through 1987. During this time, FGIS has improved both its service and its public perception as an efficient governmental service and regulatory agency.

LEGISLATION

The increased public attention given to the problems with export grain quality and the 18 percent decline in U.S. grain exports during fiscal year 1986 led to enactment of legislation to improve the quality of U.S. grain. The U.S. Grain Standards Act was amended on November 10, 1986, with the enactment of the Grain Quality Improvement Act of 1986. With exceptions for current trade practices, the new law prohibits: (1) dockage or foreign material once removed from grain from being recombined with any grain; (2) dockage or foreign material from being added to grain; and (3) reintroduction of dust to grain once removed by export elevators at export port locations. FGIS is developing plans to implement the law which will become effective May 1, 1987 To carry out the requirements of the new law, especially the enforcement of the prohibition against recombining or adding dockage or foreign material to grain, will require more personnel and therefore involve additional costs. The unbudgeted costs associated with implementation of the provisions of the new law is cause for concern.

The Grain Quality Improvement Act of 1986 also directs the Department to publish a final rule on levels of insect infestation in grain; conduct studies of premiums for high quality grain and uniform end-use value tests; and publish the optimal grain grading proposal, contained in H.R. 5534.

Other legislative action affecting grain inspection was included in the 1985 Farm Bill. The amendments require: (1) FGIS and the Agricultural Research Service to cooperate in developing new means of establishing grain classifications and to submit semiannual reports to Congress; (2) FGIS to include moisture content as a factor for grade designation if requested by a foreign government; and (3) Office of Technology Assessment, in consultation with the Secretary, to conduct a study of export quality standards and grain handling practices to assess the extent to which they have contributed to declining grain exports and submit a report to Congress.

PROGRAM

In June of 1986, the grain industry issued a Commitment to Quality Report. The intent of the report was to analyze quality problems, increase the understanding of issues relating to export grain quality and provide recommendations for resolving the quality problem. FGIS has already acted on several important Commitment to Quality Report recommendations. Effective May 1, 1987, the U.S. wheat standards will be revised to require that dockage in wheat will be certificated to the nearest 0.1 percent and that wheat protein be certified based on a constant 12.0 percent moisture. New interpretive line slides were implemented on September 1 to more adequately reflect the implications of damaged soybeans to the soybean crushing industry. Through an outside contractor, a study was conducted to evaluate the scope and performance of the FGIS Uniform Shiplot and Combined Lot Inspection Plan. This is an on line acceptance sampling plan using statistically based tolerances to monitor the overall quality of export grain shipments.

During fiscal year 1986, FGIS continued its standardization and related research activities. New standards were developed and existing ones were revised to assure that the physical and biological characteristics of grains and related commodities are uniformly and accurately described during movement through the marketing system. The standards must reflect changes in production and marketing practices. Standards reviews were conducted for lentils, whole dry peas, split peas, barley, hay, straw, and sorghum.

To improve the grain inspection system, FGIS continued to cooperate in the development of objective testing procedures. This was accomplished through FGIS research and outside contracts. Outside research contracts included studies to detect odor through the use of objective instrumentation, to determine hidden insect infestation in grain, to evaluate objective procedures for classing of wheat and to evaluate instrumentation for determining the breakage potential in corn. Selected FGIS projects include oil and protein determination by Near Infrared Reflectance (NIR) instrumentation, measuring free fatty acid in sunflower and soybean oil, and reference procedures for measuring the moisture content in grain.

The FGIS Technical Center, located in Kansas City, Missouri, is a specially designed building to provide an efficient and effective laboratory activity. U.S. Grain Standards development, grain inspection and grading research, quality control and final appeal inspection activities will be centralized at the center.

FISCAL YEAR 1988 REQUEST

Total funding for FGIS is estimated to be $44.0 million in fiscal year 1988. This consists of $7.1 million in appropriated funds for standardization, international monitoring, compliance and advisory committee activities and $36.9 million to be collected from user fees for inspection and weighing services. The appropriated request represents an increase of $244,000 in Agency standardization and compliance activities to offset increased employee salary and retirement system costs. A $27,000 increase is requested for the revolving fund to restore the limitation on inspection and weighing expenses to the amount previously approved in the fiscal year 1986 budget ($36,856,000).

ADVISORY COMMITTEE

We have continued to work closely with the FGIS advisory committee. It offers an important source of advice and assures that FGIS receives industry's view as the Agency formulates policy affecting the grain industry. The Committee made recommendations on a number of grain quality issues, including insect-related matters and certificating wheat dockage to the nearest 0.1 percent. The Committee also addressed foreign grain complaints, uniform shiploading plans, safety concerns, industry grain quality workshop recommendations, wheat classing, soybean damage interpretations, financial matters, and proposed grain quality legislation involving dust and foreign material.

SAFETY

Within the Department's grain elevator safety program, FGIS maintains the USDA Grain Explosion Reporting and Tracking System. During fiscal year 1986, 24 explosions in grain handling facilities resulted in 6 deaths and 22 personal injuries. This compared to 16 explosions resulting in 1 death and 14 personal injuries during fiscal year 1985. No Federal employees were involved in either year. Continued awareness of explosion risk has led to interaction among government, industry, union and trade associations. Substantial research and education efforts by the industry have improved dust control procedures and explosion prevention methods.

In 1982, the Department established a grain storage, handling and processing safety program and a safety subcommittee to monitor activities and promote safe grain movement. During fiscal year 1986 the subcommittee utilized the National Agricultural Library in Beltsville as an international repository for research on elevator safety. A microfiche data file on grain dust explosion research was developed. The Agency's continuing training program for collateral duty safety and health officials included classroom training provided by the OSHA, the National Institute of Occupational Safety and Health, Kansas State University, and other experts in grain handling facility safety and health.

CONCERNS

Challenging issues continue to confront the national inspection system. These include wheat classing, insect infestation, U.S. grain export volume and the associated user fee revenues.

The only acceptable method in current commercial practice for classing wheat for grading purposes is by visually examining the physical kernel characteristics. Variations of this system are used by all major grain exporting nations. No objective test currently is available which accurately classes wheat according to the present standards; however, a number of tests are currently under study by USDA, university, and industry researchers. FGIS has established a wheat classification working group, comprised of industry, university and Department representatives, to find an acceptable solution to the wheat classing problem.

Insect infestation is a major concern to foreign and domestic buyers and processors which is enhanced by the loss of certain pesticides. The concern is shared by FGIS because it identifies insect-infested grain or grain damaged by insects and certificates the results. The large quantities of grain currently stored further increase the potential for insect infestation. Initiatives taken by FGIS in this area include: (1) establishing an interagency task force on insect infestation, (2) conducting research, such as hidden insect infestation in grain, and (3) proposing revisions to the official U.S. Grain Standards with regard to insect infestation.

Another issue facing FGIS is declining U.S. grain exports. An 18 percent reduction in the volume of exported grain inspected during fiscal year 1986, combined with last year's reduction, represents a 28 percent overall decline in 2 years. This had an adverse impact on revenues as well as the Agency's inspection and weighing operations. Despite every effort to contain operating costs by staff reductions, furloughs, and other program adjustments, operating losses were incurred in fiscal year 1986. We are considering additional ways to reduce administrative support costs by consolidation of activities and eliminating duplication, where appropriate. To offset declining revenues, user fees for most FGIS services, with the exception of rice inspection, commodities inspection, and supervision of inspection and weighing activities, were recently increased. Furthermore, the costs of the new Federal Employee Retirement System, health benefits, and inflationary salary and related adjustments could increase FGIS' obligations by $4.0 million. Combined with the cost of implementing the recently enacted Grain Quality Improvement Act of 1986, these financial realities present future challenges in the management of the FGIS programs.

CLOSING

Mr. Chairman, this concludes my testimony. I would be glad to answer any questions you or other members of the Committee may have.

FOOD SAFETY AND INSPECTION SERVICE

STATEMENT OF DONALD L. HOUSTON, ADMINISTRATOR

ACCOMPANIED BY:
LESTER CRAWFORD, ASSOCIATE ADMINISTRATOR
JOSEPH A. POWERS, DEPUTY ADMINISTRATOR, ADMINISTRATIVE MANAGEMENT
WILLIAM L. WEST, DIRECTOR, BUDGET AND FINANCE DIVISION

OVERVIEW

Senator BURDICK. The next witness is Dr. Donald L. Houston.

Dr. HOUSTON. Thank you, Mr. Chairman.

I am pleased to appear before this subcommittee today to discuss the budget of the Food Safety and Inspection Service for fiscal year 1988.

Our focus during this fiscal year will be on implementation of discretionary inspection in processing plants which Congress enacted late in the last session. It is a significant change in the inspection law, and one that requires a great deal of careful planning for successful implementation. Fortunately, our work to date in modernizing the inspection program provides a solid foundation on which to build.

Later, I will report to you on the status of our work in developing regulations to implement the discretionary authority.

Before I go into the details surrounding the fiscal year 1988 budget request, I want to give you an overview of the work of the agency. As you know, our activities are performed in over 7,000 meat and poultry plants under federal inspection. Our inspectors are located throughout the country, in every state and territory.

It is through this field force that we assure the American public that their meat and poultry is safe to eat and truthfully labeled. Last year, our inspectors examined 121 million red meat animals, almost 5 billion birds, and supervised production of 67 billion pounds of processed meats and 60 billion pounds of processed poultry. In addition, they reinspected 2.4 billion pounds of imported meat.

In support of this field force, we have a highly skilled, technical and scientific staff, responsible for managing a range of activities, including the development and testing of new inspection procedures. Our scientific staff grows in importance as we confront increasingly more difficult problems of chemical and microbiological contamination of food.

In fiscal year 1986, we analyzed over 331,000 samples for residues and adulterants. Included in this number are approximately 152,000 rapid on-site test samples collected at the plant level.

BUDGET REQUEST

Mr. Chairman, our fiscal year 1988 budget request is principally one of overall program maintenance with some specifically targeted program improvements. We have submitted a request for $397.1 million for fiscal year 1988. This request allots $228.6 million for slaughter inspection, $97.6 million for processing inspection, $9.9 million for import and export inspection, $24.2 million for laboratory services, and $36.8 million for grants to states.

This budget request represents an increase of approximately $23.2 million over the amount we expect to receive in fiscal year 1987. Over half of this proposed increase—$13.3 million—will go toward the pay raise and to cover costs associated with the Federal Employees Retirement System.

An additional $4.5 million is needed to assure an adequate staffing level for the inspection force and to restore some of the staffing cuts that were necessitated last year. With this additional staff, we will be able to provide uninterrupted service to the industry, assure proper supervision of the in-plant work force, reduce the number of vacant and doubled assignments, and strengthen our residue sampling and control efforts.

INSPECTION MODERNIZATION

Mr. Chairman, we have made much progress in modernizing the inspection program since the late 1970's. We have, over the years, incorporated a number of risk-based concepts into the inspection program, examples are the total quality control program for plants with good records, and the intensified regulatory enforcement program for plants that need extra attention from us to stay on the right track.

This is a direction which was fully supported by the National Academy of Sciences in their 1985 review of the inspection program. The academy not only supported our existing efforts to place our resources where the risks are greatest, but also encouraged us to go even further in this direction.

We agreed with their advice, but we were limited by the requirement that each plant be visited daily. We now have the legislative authority to take those extra steps in processing plants.

DISCRETIONARY INSPECTION

Philosophically, one of the biggest challenges that lies ahead of us is to educate industry and consumers that discretionary inspection does not mean less overall inspection. Rather, discretionary inspection is a spectrum that includes the full range of intensity.

All processing plants would be under discretionary inspection. On one end will be plants that can remain on the right track with the inspectors there on a less than daily basis. On the other end of the spectrum will be plants that need the most intensive inspection we can offer. We plan to screen all processing plants to determine the intensity of inspection best suited to each.

We also remind those processors we regulate that enforcement provisions were part of the legislative package. USDA was given additional enforcement authority in three instances.

When a felony or multiple misdemeanor conviction occurs on charges of intentional adulteration, adulteration with intent to defraud, bribery, or extortion, USDA can seek temporary removal of an individual responsibly connected with the business pending an administrative hearing.

In the case of repeated violations of the law, USDA can ask the court to temporarily withdraw or remove a responsible individual if there is a direct and substantial threat to the public health or safety. USDA can temporarily withdraw inspection in a plant where threats or assaults against inspectors occur.

Although implementation of discretionary inspection is forging ahead, there is still much work to be done. As I am sure you can appreciate, implementation of discretionary inspection in over 6,000 processing plants is not a task that can be accomplished overnight. It requires extensive planning and pilot testing to design a system that is both equitable and practical.

However, we have set a stringent goal for ourselves. We plan to fully implement discretionary inspection during 1988.

Much of our initial attention will be focused on those processing plants that we believe can operate with minimal USDA supervision, rather than on those that require intensive oversight. This is because we have little experience with structured reductions in inspection intensity.

Another reason for starting with plants that would require less inspection is that we must free up inspection personnel before we can intensify inspection in plants at the other end of the spectrum.

PILOT TESTING

Pilot testing should begin shortly, and we expect it to take approximately 1 year. The first phase will involve just a small number of plants, about 15. We will expand the pilot to include more plants several months later. Pilot testing will allow us to accomplish a number of tasks.

First, we will be able to test the screening instruments we developed to determine the intensity of inspection that is appropriate for each plant.

In addition, we will be able to design a supervisory structure to support discretionary inspection and to determine whether our organizational structure needs revision to accommodate this new method of inspection.

As we work on implementation of discretionary inspection, we will continue modernizing other aspects of the inspection program as well. In all these efforts, our goals are similar, a more efficient and effective inspection program based on risk.

NEW INSPECTION PROCEDURES

While we approach slaughter and processing inspection differently, we do believe that these goals can apply to all areas of inspection. Beginning with implementation in 1980 of total quality control inspection for processing plants, we have been incorporating risk assessment and quality control principles into inspection procedures.

We now have over 500 plants participating in TQC and we have begun applying these principles to slaughter inspection procedures.

Early in 1986, we implemented the steamlined inspection system in broiler plants, and we expected to implement a similar system in hog and cattle plants later this year. With SIS, the responsibility for identifying and trimming manufacturing defects, which do not affect wholesomeness, is taken over by the plant. The USDA inspector monitors the plant's operation to make sure it is effective, and thus is free to concentrate on diseases and public health related abnormalities.

Further down the line, we are testing the feasibility of a computer based third generation inspection system. In this system, plant employees, who are trained by USDA, sort normal from condemnable carcasses and a computer is used to track their actions. We expect testing to be completed this spring, and at that point, we will determine whether to go forward with a regulatory proposal to implement the system.

We expect to gain further insight into improving slaughter inspection from a National Academy of Sciences report, which we expect to receive in May. It will assess public health risks associated with poultry inspection systems.

This year, we will be implementing nationwide a more structured approach to inspection in traditional processing plants, those plants not under TQC inspection.

Under the new system, an inspection system and work plan will be prepared for each plant, based on product, type of operation, and other relevant information.

This plan will be the inspector's guide and will bring a much more structured and objective approach to inspection in processing plants. It is, in essence, TQC style inspection applied to non-TQC plants, and ISWP draws heavily from our experience with TQC just as development of discretionary inspection will also draw heavily from the knowledge we gained through the TQC program.

As these new systems become part of inspection, we recognize the need to prepare our inspection force accordingly. One of our initiatives is to phase food technologists into processing inspection.

FOOD TECHNOLOGISTS

During 1986, we began training our first class of food technologists using a combination of formal classes and on-the-job training. This program, coupled with our ongoing programs to upgrade the skills of the inspection force, will prepare us for continuing an effective inspection program in the future.

NEW TESTING METHODS

In the science area, we are continuing to develop inexpensive, easy-to-use tests that can be run right at the plant. A new rapid method to detect sulfa drug residues, the sulfa onsite test will become operational this year.

Our scientists are also developing a series of species identification tests that can be done at the plant. The first of these, developed several years ago, was the overnight rapid beef identification test. We now have a species test for poultry and one for pork. Under development are tests to detect horse and sheep.

We also developed two new laboratory tests that have proved very useful. One detects pork in cooked product. The other detects poultry meat in cooked products such as bologna and hot dogs.

Up until now, we could only detect poultry in raw products. The test will help catch processors who are illegally substituting less expensive chicken or poultry byproducts for beef.

A number of cases where the test showed positive results are now under investigation, and on January 21, a federal grand jury indicted a Nashville, TN, processor for allegedly substituting poultry in a product labeled as containing only beef. The firm, and a corporate official each face 17 felony counts charging violations of the Federal Meat Inspection Act.

RESIDUE CONTROL

In the residue area, we are shifting the responsibility for the day-to-day execution of the residue control program from our residue staff to our field supervisors. Up until now, scientists with our residue staff were responsible for directing inspectors to collect samples of meat and poultry and ensuring that the samples were properly taken and that the required reporting and documentation were completed. The new system will improve reporting lines by having the inspectors' supervisors, rather than the residue staff, be responsible and accountable for these activities.

Also, in the residue area, we have developed a computerized residue violations information system which we plan to have online within the next few months. The system will keep track of residue violations nationwide. Our five regional offices will enter data into the system on residue violations in their areas.

This data can then be accessed by any authorized user within the agency or other agencies with responsibilities for animal drugs, such as the Food and Drug Administration and the Packers and Stockyards Administration.

A major advantage of the system will be that a producer marketing animals with violative levels of residues in several locations could be more easily identified as a repeat violator. Thus, it will be easier to locate and prosecute those responsible for residue violations.

IMPORT INSPECTION

The international arena is requiring increased attention from FSIS as we work to strengthen our import inspection program, and as we also focus on trade issues that threaten to disrupt our export program. Before I go into detail on these trade matters, I want to update you on two other issues relating to imports.

FSIS was one of the federal agencies involved in the aftermath of the nuclear powerplant accident in Chernobyl, U.S.S.R., last year. Immediately after the accident, we began to monitor meat and poultry imports from the affected countries for radiation. We notified all 37 nations that export meat and poultry to the United States that they must test ground contamination levels, and if unsafe levels were detected, they must institute controls to prevent radiation contamination of products destined for the United States.

At this point, we can report that the danger appears to have passed, although we will continue to be vigilant.

In another action this year, we ceased import inspection at piers, warehouses, or other facilities not specifically approved for inspection. This strengthened our ability to enforce the laws and increased efficiency in the import inspection program. We also began phasing out destination inspection, the inspection of products at destination sites rather than at ports of entry.

The exception is for products from Canada, which will be permitted to stay under destination inspection until 1989. Canadian products represented about 80 percent of the imports inspected at destination sites, and we needed the extra time to assure that adequate border inspection facilities are in place.

TRADE ISSUES

With regard to the trade issues, the controversies are on two fronts: the third country directives, and the proposed EEC ban on the use of hormones in animal production. Both pose serious threats to the continued free flow of trade between the United States and EEC member nations.

For several years now, we have been negotiating with the EEC over the third country directive, which sets very specific requirements for U.S. plants exporting to EEC member countries. Originally the cutoff was to have come in January, but the EEC has extended it to the end of the year.

Nonetheless, we continue to believe that the differences between EEC requirements and our domestic regulations have no bearing on the safety, wholesomeness, or quality of the product. It is quite clearly a trade issue, and the U.S. Trade Representative has joined the effort to seek a solution.

Another serious problem looms if the EEC goes through with its plans to ban the use of hormones in animal production. Their action is inconsistent with the data of their own scientists, but reflects the body of public concern in Europe over the use of hormones. The ban is scheduled to take effect in 1988, and it could mean the end of U.S. meat exports to EEC countries since the U.S. allowance of the use of hormones would be at variance with the EEC inspection requirements.

I have just returned from Brussels where I met with the EEC officials to try to find a way to avoid what could be a serious blow to our domestic meat industry. Various activities are underway to seek a change in the EEC position.

SALMONELLA CONTROL

The problem of salmonella in meat and poultry is not new, nor are our efforts to control it. In 1986, salmonella control and reduction remained the agency's main research priority, as it has been since 1981. In order to have the best data on the level of salmonella in poultry, we will begin a new national monitoring program for broilers in this fiscal year.

This study will update benchmark figures for salmonella prevalence and will also provide new information on the presence of other pathogens.

We are continuing to work on a proposed regulation that would allow companies to use incentive labeling if they develop superior manufacturing practices and use acetic acid sprays to further reduce microbiological contamination. This practice would be coupled with the use of voluntary microbiological standards, which we believe would lead essentially to the production of pathogen-free raw meat and poultry.

We continue to work with industry groups on reducing salmonella levels, and we are very encouraged by the commitment of the red meat industry to place a high priority on salmonella control. I am also pleased by recent actions of the poultry industry to face this problem in a more direct fashion.

We know that most food poisoning occurs because of consumer mishandling, and we conduct a comprehensive education program reaching millions of consumers each year with important food handling information. This year, we will also be releasing a special training package for food preparers who work in institutional settings such as nursing homes and hospitals.

HEPTACHLOR CONTAMINATION

In 1986, FSIS played a major role in controlling and cleaning up a heptachlor contamination incident in Arkansas and surrounding states. The feeding of a mash made from treated seed to dairy cows resulted in contaminated milk and meat and ultimately severe financial losses for many farmers.

In order to assure consumers that contaminated products were not reaching the marketplace, FSIS initiated a special sampling program for heptachlor and chlordane in meat and poultry from suspect herds and flocks.

At the height of the problem, FSIS established an onsite field office in Little Rock and instituted extensive testing for commercial meat products and products destined for the school lunch program. No school lunch products were contaminated, and we concluded that there was no widespread contamination of the meat supply.

As a precautionary measure, we initiated special hold and test procedures for suspect animals. At the end of fiscal year 1986, only 35 violations from several livestock sources had been confirmed out of almost 1,800 samples on which testing had been completed.

PESTICIDE-TREATED SEED

The incident also stimulated the federal agencies that protect the food supply to take a closer look at the potential for future contamination resulting from pesticide-treated seed being used as animal feed. The Food and Drug Administration conducted a nationwide survey of the use of treated seed in animal feed, and discussed the report at a public meeting held at USDA in July.

In addition, the Environmental Protection Agency is leading an interagency task force, which includes FSIS, looking at possible regulatory changes. FSIS is also working with the FDA, EPA, the Extension Service, and the Agricultural Marketing Service to develop educational materials for animal producers and the grain and seed industry.

PREPARED STATEMENT

This concludes my statement, Mr. Chairman. I will be glad to answer any questions that you or other members of the committee may have. I appreciate this opportunity to appear before you. Thank you.

Senator BURDICK. Thank you.

[The statement follows:]

STATEMENT OF DR. DONALD L. HOUSTON

Mr. Chairman, I am pleased to appear before this Subcommittee to discuss the budget of the Food Safety and Inspection Service (FSIS) for fiscal year 1988. Our focus during this fiscal year will be on implementation of discretionary inspection in processing plants, which Congress enacted late in the last session. It is a significant change in the inspection law and one that requires a great deal of careful planning for successful implementation. Fortunately, our work to date in modernizing the inspection program provides a solid foundation on which to build.

Over the last decade, we have made great strides in improving the efficiency and effectiveness of inspection, and we have moved toward allocating inspection resources on the basis of risk. While our progress to date has been significant, we look forward to the implementation of discretionary inspection. The concept embodied in discretionary inspection is that the most efficient inspection program is a flexible program that permits USDA to vary the intensity of inspection according to the risk inherent in a particular plant or product. That is a concept which FSIS has long believed in and one that is already installed in many aspects of our program.

Later, I will report to you on the status of our work on developing regulations to implement the discretionary authority.

I want to note that in conjunction with our budget submission, the Department will resubmit its proposal to grant USDA authority to collect user fees for meat and poultry inspection. The Adminstration's philosophy is that those directly benefitting from a service should pay for it. When I appeared before the House Appropriations Subcommittee last year, I released the agency's study on implementing the user fee system. That study remains in effect and I would refer you to it and to my previous testimony for the details of how USDA would assess and collect user fees for inspection services.

For FSIS, 1986 was a year of uncertainty as it was for many Federal agencies. However, the combined actions of the Congress and the Administration helped avert the serious situation we feared might occur when our funding was cut due to the Gramm-Rudman-Hollings law. The additional funding we received during the year allowed us to provide the level of inspection service required to keep the industry operating at full production. We were able to avoid furloughing of employees, restricting overtime and holiday service, or refusing service to new and expanded plants. The action by the Congress showed your appreciation for the negative impact such moves would have on the meat and poultry industry and on the consumer food supply.

Before I go into the details of our fiscal year 1988 budget request, I want to give you an overview of the work of FSIS. As you know, the mission of our agency is performed in over 7,000 meat and poultry plants under Federal inspection. Our inspectors are located throughout the country--in every state and territory.

It is through this field force that we assure the American public that their meat and poultry is safe to eat and truthfully labeled. Last year, our inspectors examined 121 million red meat animals, almost 5 billion birds, and supervised production of 67 billion pounds of processed meat and 60 billion pounds of processed poultry. In addition, they reinspected 2.4 billion pounds of imported meat.

We condemned 378,000 red meat carcasses and 55 million birds that were diseased, contaminated, or otherwise unsafe or unfit for human consumption. We also condemned 136 million pounds of processed product and refused entry to 15 million pounds of imported product.

In support of this field force, we have a highly skilled technical and scientific staff, responsible for managing a range of activities including the development and testing of new inspection procedures. Our scientific staff grows in importance as we confront increasingly more difficult problems of chemical and microbiological contamination of food. In fiscal year 1986, we analyzed over 331,000 samples for residues and adulterants. Included in this number are approximately 152,000 rapid on-site test samples collected under the Swab Test on Premises (STOP) and Calf Antibiotic Swab Test (CAST) programs.

FISCAL YEAR 1988 BUDGET

Our fiscal year 1988 budget request is one of overall program maintenance with some specifically targeted program improvements.

We have submitted a request for $397.1 million for fiscal year 1988. This request allots $228.6 million for slaughter inspection, $97.6 million for processing inspection, $9.9 million for import and export inspection, $24.2 million for laboratory services, and $36.8 million for grants to states.

This budget request represents an increase of approximately $23.2 million over the amount we expect to receive in fiscal year 1987. Over half of this proposed increase--$13.3 million--will go toward the pay raise and to cover costs associated with the Federal Employees' Retirement System. An additional $4.5 million is needed to assure an adequate staffing level for the inspection force and to restore some of the staffing cuts that were necessitated last year by the Gramm-Rudman-Hollings law. With this additional staff, we will be able to provide uninterrupted service to the industry, assure proper supervision of the in-plant work force, reduce the number of vacant and doubled assignments, and strengthen our residue sampling and control efforts.

Improved Data Systems

We are proposing funding for two new initiatives. We are seeking $2.4 million to improve our data processing systems. In order to manage a modern inspection program, we need information systems which will provide accurate, comprehensive data on plant operations, conditions and products which will assist in scheduling our work force.

There are several specific programs we intend to fund with this money. The first is an inspection position coverage system. This system will vastly improve our ability to perform the daily task of matching available employees to the locations where inspection services are needed--a function that is complex, yet critical to efficient, effective operation.

A second data system will document in-plant reviews, which are used to review plant conditions and to assess the effectiveness of our inspection program.

With the updated data system, we will be able to take more effective and consistent actions to correct any deficiencies noted in the reviews. Finally, we intend to make information in our Labeling Information System accessible to all authorized FSIS personnel. As a result, we will be able to process label applications more quickly and strengthen overall management of the label approval process.

Stronger Review Program

The second major initiative included in our FY 1988 budget request is $741,000 for broadening program reviews--which are an important management tool for FSIS. For some years now, we have conducted reviews of domestic operations to aid in assessing the effectiveness of the inspection program and in making changes that assure the program continues to operate correctly.

When I appeared before this committee last year, I reported that we were in the midst of a followup review in Southern California where, in 1985, employee concerns about the integrity of the inspection program had prompted us to order a large-scale internal investigation. I am pleased to report to you now that last year's follow-up review showed that the actions we took after the initial investigation were effective and that the problems had been or were being corrected. We have made significant improvements in the management of the program in Southern California.

Self-examination is never easy, but we have learned that it is extremely useful in keeping our program on track. One of the valuable things we learned from the Southern California experience was that our reviews may sometimes need to be broader than they traditionally have been. The initiative in the FY 1988 budget will permit us to conduct more of these expanded reviews in which we will look not only at plant conditions, but also at the supervisory structure and how well supervisors and their subordinates coordinate their actions to provide effective and uniform inspection coverage. We also intend to begin doing reviews of our import inspection system.

Discretionary Inspection

We've made much progress in modernizing the inspection program since the late 1970's. We have, over the years, incorporated a number of risk-based concepts into the inspection program. Examples are the Total Quality Control program for plants with good records and the Intensified Regulatory Enforcement program for plants that need extra attention from us to stay on the right track. This is a direction that was fully supported by the National Academy of Sciences in their 1985 review of the inspection program. The Academy not only supported our existing efforts to place our resources where the risks are greatest, but also encouraged us to go even further in this direction. We agreed with their advice, but we were limited by the requirement that each plant be visited daily. We now have the legislative authority to take those extra steps in processing plants.

Philosophically, one of the biggest challenges that lies ahead is to educate industry and consumers that Discretionary Inspection does not mean less overall inspection. Rather, Discretionary Inspection is a spectrum that includes the full range of inspection intensity. All processing plants will be under Discretionary Inspection. On one end will be plants that can remain on the right track with the inspector there on a less-than-daily basis. On the other end of the spectrum will be plants that need the most intensive inspection we can offer. We plan to screen all processing plants to determine the intensity of inspection best suited to each.

We also must remind those processors we regulate that enforcement provisions were part of the legislative package. USDA was given additional enforcement authority in three instances.

(1) When a felony or multiple misdemeanor conviction occurs on charges of intentional adulteration, adulteration with intent to defraud, bribery, or extortion, USDA can seek temporary removal of an individual responsibly connected with the business pending an administrative hearing.

(2) In the case of repeated violations of the law, USDA can ask the Court to

temporarily withdraw inspection or remove a responsible individual if there is a direct and substantial threat to the public health or safety.

(3) USDA can temporarily withdraw inspection in a plant where threats or assaults against inspectors occur.

Although implementation of Discretionary Inspection is forging ahead, there is still much work to be done. As I'm sure you can appreciate, implementation of Discretionary Inspection in over 6,000 processing plants is not a task that can be accomplished overnight. It requires extensive planning and pilot testing to design a system that is both equitable and practical. However, we have set a stringent goal for ourselves. We plan to fully implement Discretionary Inspection during 1988.

Much of our initial attention will be focused on those processing plants that we believe can operate with minimal USDA supervision rather than on those that require intensive oversight. This is because we have little experience with structured reductions in inspection intensity. Another reason for starting with plants that would require less inspection is that we must free up inspection personnel before we can intensify inspection in plants at the other end of the spectrum.

Pilot testing should begin shortly, and we expect it to take approximately one year. The first phase will involve just a small number of plants--about 15. We will expand the pilot to include more plants several months later. Pilot testing will allow us to accomplish a number of tasks. First, we'll be able to test the screening instruments we developed to determine the intensity of inspection that is appropriate for each plant. In addition, we will be able to design a supervisory structure to support Discretionary Inspection and to determine whether our organizational structure needs revision to accommodate this new method of inspection.

INSPECTION MODERNIZATION

As we work on implementation of discretionary inspection, we will continue modernizing other aspects of the inspection program as well. In all these efforts, our goals are similar: a more efficient and effective inspection program based on risk.

While we approach slaughter and processing inspection differently, we do believe that these goals can apply to all areas of inspection. Beginning with implementation in 1980 of Total Quality Control Inspection for processing plants, we have been incorporating risk assessment and quality control principles into inspection procedures. We now have over 500 plants participating in TQC and we have begun applying these principles to slaughter inspection procedures. Early in 1986, we implemented the Streamlined Inspection System (SIS) in broiler plants, and we expect to implement a similar system in hog and cattle plants later this year.

With SIS, the responsibility for identifying and trimming manufacturing defects--which do not affect wholesomeness--is taken over by the plant. The USDA inspector monitors the plant's operation to make sure it is effective, and thus is free to concentrate on diseases and public health-related abnormalities. Further down the line, we are testing the feasibility of a computer-based "third generation" inspection system. In this system, plant employees, who are trained by USDA, sort normal from condemnable carcasses and a computer is used to track their actions. We expect testing to be completed this spring, and at that point, we will determine whether to go forward with a regulatory proposal to implement the system.

We expect to gain further insight into improving slaughter inspection from a National Academy of Sciences report, which we expect to receive in March. It will assess public health risks associated wih poultry inspection systems.

This year, we will be implementing nationwide a more structured approach to inspection in traditional processing plants--those plants not under TQC inspection. Under the new system, an Inspection System and Work Plan (ISWP) will be prepared for each plant based on product, type of operation, and other relevant information. This plan will be the inspector's guide and will bring a much more structured and objective approach to inspection in processing plants. It is, in essence, TQC-style inspection applied to non-TQC plants, and ISWP draws heavily from our experience with TQC just as development of discretionary inspection will also draw heavily from the knowledge we gained through the TQC program.

As these new systems become part of inspection, we recognize the need to prepare our inspection force accordingly. One of our initiatives is to phase food technologists into processing inspection. During 1986, we began training our first class of food technologists using a combination of formal classes and on-the-job training. This program, coupled with our on-going programs to upgrade the skills of the inspection force, will prepare us for continuing an - effective inspection program in the future.

IMPROVEMENTS IN THE SCIENCE PROGRAM

In the Science area, we are continuing to develop inexpensive, easy-to-use tests that can be run right at the plant. A new rapid method to detect sulfa drugs residues, the Sulfa-On-Site Test will become operational this year. Our scientists are also developing a series of species identification tests that can be done at the plant. The first of these, developed several years ago, was the Overnight Rapid Beef Identification Test. We now have a species test for poultry and one for pork. Under development are tests to detect horse and sheep.

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Also in the residue area, we have developed a computerized Residue Violations Information System which we plan to have on-line within the next few months. The system will keep track of residue violations nationwide. Our five regional offices will enter data into the system on residue violations in their areas. This data can then be accessed by any authorized user within the agency or other agencies with responsibilities for animal drugs, such as the Food and Drug Administration and the Packers and Stockyards Administration. A major advantage of the system will be that a producer marketing animals with violative levels of residues in several locations could be more easily identified as a repeat violator. Thus, it will be easier to locate and prosecute those responsible for residue violations.

INTERNATIONAL ISSUES

The international arena is requiring increased attention from FSIS as we work to strengthen our import inspection program, and as we also focus on trade issues that threaten to disrupt our export program. Before I go into detail on these trade matters, I want to update you on two other issues relating to imports.

FSIS was one of the Federal agencies involved in the aftermath of the nuclear power plant accident in Chernobyl, U.S.S.R., last year. Immediately after the accident, we began to monitor meat and poultry imports from the affected countries for radiation. We notified all 37 nations that export meat and poultry to the U.S. that they must test ground contamination levels, and if unsafe levels were detected, they must institute controls to prevent radiation contamination of products destined for the U.S.

At this point, we can report that the danger appears to have passed although we will continue to be vigilant.

In another action this year, we ceased import inspection at piers, warehouses, or other facilities not specifically approved for inspection. This strengthened our ability to enforce the laws and increased efficiency in the import inspection program. We also began phasing out destination inspection--the inspection of products at destination sites rather than at ports of entry. The exception is for products from Canada, which will be permitted to stay under destination inspection until 1989. Canadian products represented about 80 percent of the imports inspected at destination sites, and we needed the extra time to assure adequate border inspection facilities are in place.

With regard to the trade issues, the controversies are on two fronts: the Third Country Directive and the proposed EEC ban on the use of hormones in animal production. Both pose serious threats to the continued free flow of trade between the U.S. and EEC member nations.

For several years now, we have been negotiating with the EEC over the Third Country Directive, which sets very specific requirements for U.S. plants exporting to EEC-member countries. Originally the cutoff was to have come in January, but the EEC has extended it to the end of the year. Nonetheless, we continue to believe that the differences between EEC requirements and our domestic regulations have no bearing on the safety, wholesomeness or quality of the product. It is quite clearly a trade issue, and the U.S. Trade Representative has joined the effort to seek a solution.

Another serious problem looms if the EEC goes through with its plans to ban the use of hormones in animal production. Their action is inconsistent with the data of their own scientists, but reflects the body of public concern in Europe over the use of hormones. The ban is scheduled to take effect in 1988, and it could mean the end of U.S. meat exports to EEC countries since the U.S. allowance of the use of hormones would be at variance with the EEC inspection requirements.

I have just returned from Brussels where I met with the EEC officials to try to find a way to avoid what could be a serious blow to our domestic meat industry. Various activities are underway to seek a change in the EEC position.

MICROBIOLOGICAL CONTROL

The problem of salmonella in meat and poultry is not new, nor are our efforts to control it. In 1986, salmonella control and reduction remained the Agency's main research priority, as it has been since 1981. In order to have the best data on the level of salmonella in poultry, we will begin a new national monitoring program for broilers in this fiscal year. This study will update "benchmark" figures for salmonella prevalence and will also provide new information on the presence of other pathogens.

We are continuing to work on a proposed regulation that would allow companies to use incentive labeling if they develop superior manufacturing practices and use acetic acid sprays to further reduce microbiological contamination. This practice would be coupled with the use of voluntary microbiological standards, which we believe would lead essentially to the production of pathogen-free raw meat and poultry.

We continue to work with industry groups on reducing salmonella levels, and we are very encouraged by the commitment of the red meat industry to place a high priority on salmonella control. I am also pleased by recent actions of the poultry industry to face this problem in a more direct fashion.

We know that most food poisoning occurs because of consumer mishandling, and we conduct a comprehensive education program reaching millions of consumers each year with important food handling information. This year, we will also be releasing a special training package for food preparers who work in institutional settings such as nursing homes and hospitals.

HEPTACHLOR CONTAMINATION IN ARKANSAS

In 1986, FSIS played a major role in controlling and cleaning up a heptachlor contamination incident in Arkansas and surrounding states. The feeding of a mash made from treated seed to dairy cows resulted in contaminated milk and meat and ultimately severe financial losses for many farmers.

In order to assure consumers that contaminated products were not reaching the marketplace, FSIS initiated a special sampling program for heptachlor and chlordane in meat and poultry from suspect herds and flocks. At the height of the problem, FSIS established an on-site field office in Little Rock and instituted extensive testing for commercial meat products and products destined for the school lunch program. No school lunch products were contaminated, and we concluded that there was no widespread contamination of the meat supply.

As a precautionary measure, we initiated special "hold and test" procedures for suspect animals. At the end of fiscal year 1986, only 35 violations from several livestock sources had been confirmed out of almost 1,800 samples on which testing had been completed.

The incident also stimulated the federal agencies that protect the food supply to take a closer look at the potential for future contamination resulting from pesticide-treated seed being used as animal feed. The Food and Drug Administration conducted a nationwide survey of the use of treated seed in animal feed, and discussed the report at a public meeting held at USDA in July. In addition, the Environmental Protection Agency is leading an inter-agency task force, which includes FSIS, looking at possible regulatory changes. FSIS is also working with FDA, EPA, the Extension Service, and the Agricultural Marketing Service to develop educational materials for animal producers and the grain and seed industry.

CONCLUSION

This concludes my statement, Mr. Chairman. I will be glad to answer any questions you or other members of the Committee may have. I appreciate this opportunity to appear before you.

STATUS REPORT ON THREE PROMOTION PROGRAMS

Senator BURDICK. Three promotion programs were adopted as part of the Food Security Act of 1985. They relate to improving the domestic and international marketing of beef, pork and watermelons. Would you please provide the committee with a status report on these programs?

Mr. BOYLE. A National Research and Promotion Program for beef was initiated on October 1, 1986. Assessments are now being collected on both domestic and imported products. The Beef Committee, which administers the program, has contracted with the National Cattlemen's Association for administrative services and with the Beef Industry Council for research and promotion. The Council has contracted with television stars Cybill Shepard and James Garner to be spokespersons in an ad campaign entitled, "Beef—Real Food for Real People," appearing in television, radio and print advertising

The National Research and Promotion Program for pork began on November 1, 1986. Similar to beef, assessments are now being collected on domestic and imported products. The Pork Board has contracted with the National Pork Producers' Council to handle all the administrative activities as well as research and promotion efforts. The Council's advertising and promotion theme, "Pork, the Other White Meat," will be promoted by Peggy Fleming. She will make personal as well as guest appearances on television talk shows.

We will be holding a producer referendum to see whether or not a majority of producers would support the watermelon research and promotion program, and if so, we will begin to collect assessments at an appropriate time in the future after the order is implemented.

Senator BURDICK. Do you have information that would indicate the requested refund rate for the beef and pork program?

Mr. BOYLE. Although our experience is limited to the past few months, the early indications are that the refund rate will be less than 10 percent for both the beef and pork promotion programs.

PLANT VARIETY REGISTRATION ACTIVITIES

Senator BURDICK. Under current law, the registration activities under the Plant Variety Protection Act would require an increase of $28,000 in fiscal year 1988. What is the current fee charged to developers who wish to certify a variety of plant seeds?

Mr. BOYLE. I would be happy to answer that question, Mr. Chairman. When a developer submits an application for a plant variety protection certificate, it is accompanied by an application fee in the amount of $1,800. That fee basically covers the cost of analyzing the application, reviewing relevant data, and maintaining a data base on a variety of seeds that have already been approved. An additional $200 is charged when we award approved certificates.

When the $2,000 application fee is collected, it is deposited in a miscellaneous receipts account at the U.S. Treasury. As a result, an annual appropriation from Congress is required to fund the operation of the plant variety protection program.

We have submitted legislation that would change that accounting practice and would allow the agency to retain the $2,000 application fee to fund the program. This change would eliminate the need for an annual appropriation, but would not increase the application fees that applicants are required to pay.

Senator BURDICK. In other words, you are not considering increasing the amount of these fees?

Mr. BOYLE. No, Mr. Chairman.

EGG PROCESSING

Senator BURDICK. Among the legislation proposed by the administration is a sharp reduction in the current continuous in-plant inspection of egg processing and the imposition of user fees to recover inspection and surveillance service cost. What would be the level of savings attributed to this legislation in fiscal year 1988?

Mr. BOYLE. The two changes to which you refer, Mr. Chairman, would be the result of two separate pieces of legislation that require congressional action.

The user fee proposal which has been submitted to Congress, would result in a savings of about $9.5 million annually in the egg products inspection area.

That proposal is part of a larger user fee initiative that also involves the programs of Dr. Houston. Perhaps Dr. Houston would like to expand upon that aspect of it.

USER FEES FOR MEAT AND POULTRY INSPECTION

Dr. HOUSTON. In regard to user fees, the administration has legislative packages before the Congress, which, if enacted, would give us the authority to utilize user fees to defray costs for the meat and poultry inspection programs, and for fiscal year 1988, that would be $397 million.

The user fee plan itself would remain the same as we provided this committee last year.

USER FEES FOR EGG PRODUCTS INSPECTION

Senator BURDICK. If this proposal you are talking about is adopted, what would be the percentage decrease in egg production inspection and surveillance visits in fiscal year 1988?

Mr. BOYLE. Mr. Chairman, the adoption of a user fee proposal would not result in the reduction of inspections in the egg products plants or in our visits to the egg hatcheries, or shell egg grading plants. There is another legislative proposal under consideration in the department that would allow us to administer the Egg Products Inspection Act with less-than-continuous inspection authority.

That proposal has been submitted to Congress in previous years and is very much patterned after the less-than-continuous inspection authority that Congress approved for the meat and poultry inspection program during the last Congress. Dr. Houston has talked a little bit about how that is being implemented in his area.

In terms of specifically how it would affect the visits and the level of inspections, that would vary from plant to plant depending upon the nature of the operation. For example, in the egg products inspection plant there are two operations involved.

One is the breaking of eggs and the other is the further processing of those eggs, which includes the drying, freezing, or packaging of egg products. Under a less-than-continuous inspection authority proposal, we would continue to provide continuous inspection of the egg breaking part of that operation. We would provide less-than-continuous inspection in the processing part of the operation where we can monitor mechanical surveillance equipment.

In the shell egg plant, we are required under current law to provide at least a minimum of four visits a year. The proposal that is under consideration would allow us to provide, at a minimum, one annual visit to those plants. We use our discretion to provide a greater number of visits to plants, when we think it is necessary.

Senator BURDICK. One thing that occurs to me is, whether it is egg inspection or meat inspection, when they are noncontinuous programs, when you do inspect, is the time and the place known ordinarily? What is the procedure?

Mr. BOYLE. In the egg products plants, we are there whenever they are operating, so there are no surprises to them. We are there as long as they are producing.

When we make quarterly visits to the egg hatcheries or the shell grading plants they are unannounced visits, so that would be a surprise to the owners and operators of those plants.

MEAT INSPECTION

Senator BURDICK. Is that true with meat, too, that the inspections are unannounced?

Dr. HOUSTON. Mr. Chairman, at this point, we have not implemented the discretionary authority, and our inspectors are still in the processing plants every day, visiting them daily. It is our intention, though, when we go to the less than daily visits, they would be unannounced.

Senator BURDICK. Gentlemen, the reason I ask you these questions is that I was on the Judiciary Committee for many years, where I chaired the penitentiary subcommittee. I know where all the penitentiaries are now. [Laughter.]

We would have inspection of food processes and so forth, and we would try to get to the penitentiaries when they didn't know we were coming. I want to find out if that is the same type of procedure you are using here? Is that right?

Dr. GILLES. That would be the way it operates, yes, sir.

GRADING PROCEDURES

Senator BURDICK. The grading procedures instituted by USDA assure consumers that they are receiving quality food items. Would you please tell the committee about your proposals to change the USDA grade name from "Good" to "Select?"

Mr. BOYLE. Mr. Chairman, last year the Department received a proposal from a consumer organization suggesting that we change the USDA grade name from "Good" to "Select" in an attempt to eliminate the impression that it is inferior and less desirable than "Choice" or "Prime" in the minds of consumers. We have reviewed the proposal, and have published it in the Federal Register.

In the last few weeks, we have received comments from interested parties. There is a 60-day comment period that will be expiring in early May. At that point we will review the comments and make a final decision on that proposal.

GRAIN EXPORTS

Senator BURDICK. The next question is for Mr. Miller.

I note in your testimony that because of the reduced grain exports throughout fiscal year 1986, the FGIS fund has been experiencing a significant loss.

What is your expectation or prediction for exports for 1987?

Mr. MILLER. Mr. Chairman, we are looking at a fairly stagnant export situation. In the year ahead we expect a very modest increase. It looks like wheat exports may be up as much as 12 percent, but, unfortunately, corn exports, at best, are going to be flat, and probably, soybean exports will be down.

Senator BURDICK. Is that because exports haven't made much of a dent in our sharecropping?

Mr. MILLER. I guess not.

Senator BURDICK. Do you expect the decrease to level off, or are we looking at a possible increase in exports?

Mr. MILLER. Mr. Chairman, I would hope for an increase as a result of some of these improvements we are going to make. The result of the implementation of the Grain Quality Improvement Act may actually result in an increase in exports. We have already had indications from more than one customer, that they are very pleased with some of the actions that we are proposing to take in regards to the implementation of the new law.

As a result, I expect that eventually we will see an upturn in business. I don't think that we can expect that there will be an immediate response. It took a long time to lose our market share, and it will take a long time to regain our market share. Hopefully, over time, we will regain a large part of that lost business.

GRAIN QUALITY

Senator BURDICK. The next question is on grain quality. The Grain Quality Improvement Act of 1986 was recently enacted and prohibits the recombination of the dockage and material that was removed from grain, the addition of dockage, or foreign material, to grain, and the reintroduction of dust to grain that was previously removed. This law is scheduled to become effective on May 1, 1987, this year. Is this foreign matter really reinjected into the grain at times, is there proof of that?

Mr. Miller. The current grade standards include a factor called broken corn foreign material. Therefore, foreign material as a part of broken corn has been allowed to be reintroduced back in the grain. Exporters, in order to achieve a uniform end-product, often separate a portion of the broken corn foreign material from the lot, and then recombine it back uniformly to the grade limit.

So, technically, yes, foreign material was allowed to be recombined. As a matter of course, though, objects that are not organic material or not grain material were not allowed to be put back in. That is considered to be adulteration, and it is not permitted.

I would also say that, as a result of the new prohibition on recombination of foreign material, we are going to be required to develop new definitions for foreign material and broken kernels for corn and sorghum.

Both of these factors would combine broken kernel foreign material, combine factors, and the new law would require us to break out its definition for the new broken kernel portion. In the case of broken corn, it will be defined, broken sorghum will be defined, and elevator operators will be allowed to recombine broken kernels of grain with grain from which it was taken out of, but they will not be permitted to recombine the foreign material portion.

Senator Burdick. I am not an elevator operator, but it seems to me, once you get the broken kernels out, why do you want to put them back there? Can't you handle them separately?

Mr. Miller. The broken kernel portion does have economic value to feed lots, and to most customers overseas, and to that extent there is really not a problem with recombining the broken kernels back in with the grain, if it is done within the limits of a grade standard.

Senator Burdick. The other foreign material is out, but then they recombine the broken with the whole kernels. Does that make a better product for sale?

Mr. Miller. It wouldn't necessarily make a better product, but it definitely doesn't detract from the quality of the product either, if it is done within the limits of grade standard.

Senator Burdick. The Grain Quality Improvement Act of 1986 which was recently enacted prohibits recombination, and it issued a deadline of May 1, 1987. Can you meet it?

Mr. Miller. It is going to be very difficult, Mr. Chairman, to meet that deadline. I think that we are going to do everything we can to try to have the regulations to implement it final by that time, but in some cases it is going to require elevators to do intensive retrofitting of their operations and install new equipment. Probably, it will be impossible for some of these firms to meet the deadline dictated by the new law.

We are going to really try to do everything possible to meet the requirements of the new law, and we are going to be as responsible as we can in trying to put forth regulations and procedures that will allow them to comply with the law.

Senator BURDICK. How many additional personnel will be needed to implement the new law?

Mr. MILLER. It is still a little early for us to tell. Relative to recombination of kernels at the export houses, we think that we can handle this with the existing personnel at the export elevators. Relative to trying to monitor the prohibitions at the interior, we are going to rely heavily on the trade. We don't have authority to do mandatory official inspections in the interior. We don't do, as a matter of course, official inspections in the country elevators and inland terminals. We would look to the trade to police itself, and any violations that are reported will be dealt with the same as we do with deceptive loading cases and other violations of the law.

Senator BURDICK. Getting back to the other question I asked you. How is it done, or how do you distinguish between a cracked kernel of corn and a piece of millet, or something else? How do you make that decision?

Mr. MILLER. The new law would require us to develop a definition for broken kernels of grain. That will be accomplished by defining material that passes through various sizes of sieves. In the case of broken corn, for instance, it will be defined as all matter passing through a twelve sixty-fourths round-hole sieve and all matter remaining on top of either an eight sixty-fourths or a six sixty-fourths round-hole sieve. That portion that passes through the smaller sieve will be classified as foreign material.

In the case of sorghum, all matter that passes through a five sixty-fourths triangular-hole sieve and all matter that stays on top of a two-and-one-half sixty-fourths round-hole sieve, is considered to be broken kernels of sorghum.

Senator BURDICK. How am I to accept that the things on top are good?

Mr. MILLER. The portion that passes through the smaller screen sizes and any nongrain material that remains on top of the larger screen would be considered to be foreign material.

USER FEES

Senator BURDICK. You propose to implement user fees which would cover 100 percent of your programs and indicate that some of the direct beneficiaries are the producers and the merchandisers. Under this proposal, will producers, that is, farmers, be forced to pay user fees.

Mr. MILLER. We realize that if we transfer the $7.1 million appropriation request to user fees, the cost will be borne by those who currently use our official inspection system. That is the grain trade, the exporters, and the merchandisers in the interior. Very little of the cost of the current official inspection system is borne directly by producers. Those costs, however, will be indirectly passed back to the producers in the form of probably a lower price. They are the ones who eventually carry the brunt of the cost.

Senator BURDICK. I hope that there won't be any charge for this. Considering the work, there might be a certain given price later on.

Mr. MILLER. The fees would be charged to the current users of the official inspection system. FGIS would have to increase fees to offset the costs, and we would expect to take additional cost reduction measures to offset part of the transferred funds. User fees would be borne by folks who are currently paying for official inspections.

Senator BURDICK. Then the farmer gets part of this bill, some percentage.

Mr. MILLER. It would tend to be a very, very small percentage.

WHEAT CLASSIFICATION

Senator BURDICK. I understand that FGIS is looking into the problem of wheat classification, with recent advancements in genetics and breeding, some of the wheat classes are beginning to look like each other. Could you briefly describe the situation with regard to wheat classification?

Mr. MILLER. The current classification system is based on external examination and the morphological characteristics of the kernel. It is becoming increasingly difficult to distinguish between the different classes of wheat.

We are currently looking at several research projects. We have developed some new objective testing methodologies. These new devices are still in the experimental stage, and probably, at best, 2 years away from being commercially available.

SALMONELLA IN POULTRY

Senator BURDICK. I have a few questions for Dr. Houston.

I am extremely concerned about receiving reports on the high incidence of salmonella in poultry. One report indicated that nearly 4 out of 10 chickens are contaminated with salmonella. Do you disagree with this assessment? Is there a dramatic increase over recent years, and if so, what is this increase attributed to?

Dr. HOUSTON. It is not an increase, Mr. Chairman, it is a level that has been noted in poultry for a number of years, going back 15 or 20 years. That incidence rate has not changed. Some recent press reports have indicated that there has been a rise, but that is not true.

It is a problem of some duration, and we recognize it and the poultry industry recognizes it. I have to say that they are in the process of putting together plans to reduce the incidence. Based on recent discussions with them, I think there will be programs put in place over the next 6 months to a year, where we will see improved manufacturing practices at the plant level. I am hopeful that we will see a decline in the incidence rate.

We also have made salmonella control in red meat and poultry our No. 1 research priority within the Department. We are also continuing to carry out a very extensive consumer education program, which has been underway for many years.

POULTRY INSPECTION

Senator BURDICK. I understand that the National Academy of Sciences is expecting to issue a report on federal poultry inspection. What do you expect that report to say, and when do you expect the report to be released?

Dr. HOUSTON. The report will be out in May according to the National Academy. They have not made any copies of it available to the USDA yet. It is still in the process of being finalized and evaluated.

I think it would be premature for me to make any statement about what is in that report.

IMPLEMENTATION OF NEW LEGISLATION

Senator BURDICK. Last year, a new law was passed which allows for the discretionary inspection of meat processing plants. I am interested in how you will be implementing this new legislation. Your statement indicates that discretionary inspection involves a wide range. Does one end of that spectrum constitute constant inspection, and what is the other end of the spectrum?

Dr. HOUSTON. Based on its history, there would continue to be inspection on a daily basis, and those would be the plants where there might not be a good compliance record, or there is not a commitment by plant management to comply when it is necessary.

On the other hand, there will be situations where there are plants that are considered to be low risk for public health reasons and where they have a good compliance history, and we may look at those plants on a weekly basis, sometimes maybe two or three times a month, but again it will be based mostly on compliance history and the quality of management within the plant.

Senator BURDICK. As I said earlier in this examination today, I would hope, based upon my experience from the Senate Judiciary Committee, that you are not announcing inspection dates. You get a better product when you don't.

Dr. HOUSTON. We don't plan to, Mr. Chairman.

Senator BURDICK. Would you like to pose questions, Mr. Grassley?

INCREASED STANDARDS

Senator GRASSLEY. Thank you, Mr. Chairman. I wasn't here to hear your testimony, but I want to say that I had asked some questions of Dr. Gilles at a previous meeting, so I am not going to repeat those questions now, even though they probably should have been asked at this meeting instead of the previous one.

In the meantime, I want to say that I have had an opportunity to have some people from your agency come up and brief me on the recent negotiations going on between the United States and the European Community on the subject of the increased standards, which the European Community want our exports to meet.

I want to say thank you for that staff responding so, not only so timely, but also in a very good update.

PACKING PLANTS

My questions deal with domestic issues this morning, and this is somewhat a followup on a question that I asked Dr. Gilles, but let me say this, in regard to the meat inspection being paid for by the packing plants, I know this is about the third or fourth year this has been in the President's budget. Did you consider the low profit within the meat packing industry? That profit for the entire industry was about $500 million in the last year of recording, 1985. It seems to me that, I think, the increased fees would be about $400 million.

In light of that, did you take into consideration the weak profitable position of the meat packing industry, or was it just assumed that this is just going to be passed on?

Dr. HOUSTON. We assumed that the costs would be passed on, and would flow with the product in the direction of the consumer, or to another processer who would utilize it in the production of processed meats.

The system we have designed would create a cost per animal slaughtered or per bird slaughtered, and that is how we would capture those moneys. Those costs would just flow with that product.

Senator GRASSLEY. I need to ask you though, in the consideration of this, what consideration was given to the low profitability of the industry and the fact that in my state a lot of meat packing companies are closing? I am not asking you just to respond to that fact in my state, but I state that as an economic condition of the industry.

Dr. HOUSTON. I don't think that we gave that much consideration, quite honestly. We tried to design a system that was equitable and would work, and that we would pass those costs along in the food system.

Senator GRASSLEY. This is in regard to grain quality. Last year, the Congress passed some major legislation dealing with grain quality. I would like to know how the implementation of that legislation is going?

GRAIN QUALITY IMPROVEMENT ACT

Mr. MILLER. Senator Grassley, the Federal Register Notice for the implementation of the Grain Quality Improvement Act appeared in the Federal Register last Friday, March 13, and this was the portion of the regulations that includes prohibitions against recombination of dockage or foreign material. The proposal includes new definitions for broken corn, and broken sorghum, which may be recombined with those grains.

It also restricts adding dust to grain only at export elevators.

Senator GRASSLEY. Did you find any difficulty in writing it?

Mr. MILLER. The new Grain Quality Improvement Act also mandated that the Federal Grain Inspection Service propose rules to more accurately reflect insect levels, and that docket was published yesterday.

Senator GRASSLEY. Was this a difficult area to write regulations in?

Mr. MILLER. Yes, it was.

Senator GRASSLEY. We have a lot of literature printed, magazines, periodicals, et cetera, pointing out some problems that I suppose have to do with legislation, maybe the intricacies of it, I don't appreciate it entirely. The problem, obviously, was great. The need for the legislation was very legitimate.

Considering some of the problems that have been pointed out since, I am very interested in that legislation, and I would like to say that I would be willing to work with you, if you found some problems that you are not able to work through in a timely fashion through the legislation. Maybe there is no need for it. Even though it is a tough area, maybe you feel that you were able to solve all of those problems, or are there still some unanswered problems?

Mr. MILLER. Senator Grassley, there is no question that some of the provisions are controversial. Some other provisions for treating dust at the export elevator will require the retrofitting of dust collection equipment.

It is going to be a very costly, and very time consuming activity for the elevators to undertake, and obviously, very controversial with the trade. The trade is not convinced that it will result in enough additional export gains to offset the cost of compliance.

We are moving ahead with the regulations as we understand the instructions from Congress as provided in the law. We expect that we will have regulations implemented by the May 1 date or very close thereafter.

USER FEES

Senator GRASSLEY. Have you considered the user fees that you are proposing for grain inspection adversely impacting upon our competitive position in international trade?

Mr. MILLER. Actually, we are talking about transferring from appropriated funds to user fees $7.1 million. When we spread that cost over the total number of bushels of grain exported from the United States, it is really an infinitesimal amount of money per bushel of export grain. I don't think, quite frankly, that is going to be a major impediment to our export trade.

It is additional cost, however, and I think we need to recognize it as such.

Senator GRASSLEY. Let me ask this, is that amount of mcney, that $7.5 million, the total cost that the taxpayers are paying today that is going over to user fees?

Mr. MILLER. $7.1 million.

Senator GRASSLEY. Is this a smaller amount of fee request being shifted at this time than in previous fiscal years? As I remember from previous fiscal years, it seemed to me like it was going to have a much more dramatic impact upon our competitive position than you indicate for this year.

Mr. MILLER. In 1981 user fees were 56 percent of our budget and in 1986 user fees were up to 84 percent of our budget. The costs that we are proposing for transfer this year are less than those in 1982.

Senator GRASSLEY. I guess I would have to agree with you, but that wouldn't have been true in previous years, there wouldn't have been greater concern at that particular time.

Mr. Chairman, I have one or two other questions I would like to submit in writing, because I have to go to the meeting of the Budget Committee.

Senator BURDICK. We will now hear from the Senator from the great state of Tennessee.

OPPOSITION TO USER FEES

Senator SASSER. Thank you, Mr. Chairman.

Dr. Houston, I am sure this has been discussed before my arrival.

I apologize, Mr. Chairman, for being late. There was a meeting of the Defense Appropriations Subcommittee this morning, we discussed appropriations for the Strategic Defense Initiative. There was a meeting of the Governmental Affairs Committee this morning at 9:30. There is a meeting of the Budget Committee, which started at 10, on which I serve.

I did want to stop by this committee meeting before going up there and bring up the point that we need to do something about staggering these Appropriation Subcommittee meetings so that we can be here, if at all possible.

Dr. Houston, I note that once again the Food Safety and Inspection Service has proposed the implementation of user fees for meat and poultry inspection. I have strongly opposed those fees in the past, and unless I hear something today to change my mind, I will strongly oppose their imposition during this budget cycle.

It is one thing to impose user fees on those industries where the service is voluntary and perhaps beneficial to the industry itself, but it is another thing to impose user fees of industries where the imposition of these user fees is made on mandatory services.

You stated in reply to questions from the subcommittee chairman that these user fees, you anticipated, would be passed on to the consumer. It would be passed on to the consumer in the form of higher cost. Somehow, it just doesn't seem fair and equitable to me that the widow on social security would have to pay the same amount of inspection fee on the chicken that she buys, that the most wealthy citizen in town pays on the chicken that he or she buys, although the most wealthy citizen would probably eat lobster on which there is no inspection fee, but there would be an inspection fee on the chicken that the woman on social security is buying.

How do you justify imposing a user fee on a service where inspection service is mandatory on the part of the federal government?

It appears to me that inspections are a basic function that guarantee that certain foods are wholesome and kept wholesome, that ought to be paid for out of general revenues, and ought not to be a tax imposed upon the consumer. If you follow that logic, we also would try to impose a tax on the water that we drink, by the federal government, to guarantee wholesome water in certain areas of the country.

What is your rationale for imposing user fees on people for having this service?

Dr. HOUSTON. For meat and poultry inspection, the administration believes that those who benefit from the service should pay for it. These are the packers and processors who receive those services. It is believed that those costs should be borne by users of the service. That is the basic rationale for it.

I might add that the administration has prepared a legislative package that has been delivered to the House and the Senate, but to the best of my knowledge no one has yet agreed to introduce that legislation.

At this point, while it is a proposal, there does not seem to be anyone eager to introduce that legislation. Nevertheless, it is here, should someone wish to support it.

Senator SASSER. I don't think there is going to be a great rush, Dr. Houston, to sign over that legislation. I am sure that you can understand.

In my view, Mr. Chairman, what we are saying here is, the imposition, the intent by the administration is simply to impose a tax on those who consume meat and poultry in this country under the guise of calling it a user fee. They are sending it all across the board, a 10-percent cut in the budget, which the administration has advanced this year.

They are saying no new taxes, but they are raising about $35 billion in official revenues, and that is coming from things like user fees. Those aren't taxes—those are fees. There is a distinction between taxes and user fees in the minds of those who overrun and oversee. Of course, the remainder of the revenues are raised through the one-time sale of government assets.

If we are not careful we will soon be winnowing out the Food Safety and Inspection Service and other very vital and crucial services rendered by the Department of Agriculture, we will be leasing those out.

I just wanted to come by this morning and state my continuing firm opposition to the imposition of user fees for the inspection of meat and poultry in this country. The citizens of this country are entitled to wholesome food, we settled that issue almost 100 years ago. It is a legitimate function of the federal government that ought to be paid out of federal revenues, and I intend to see that it does.

I wanted my views to be made clear, and perhaps my other colleagues in the Senate may choose to join me.

Thank you, Mr. Chairman.

Senator BURDICK. The gentleman from Mississippi, Senator Cochran.

FUNDING FOR MARKET NEWS

Senator COCHRAN. Thank you, Mr. Chairman.

This year the budget recognizes the requirements of current law, and is, I think, more helpful to the committee, because it doesn't presume that every suggested change in legislation will be enacted and, therefore, change the budget figures. I think that this is a very helpful step in the right direction, and I thank you for your cooperation and your assistance in that regard.

In my state of Mississippi, one of the livestock market reporters resigned recently. There was some concern that because of the proposal to decrease funding in the market news activity of AMS, there may not be a replacement provided. This concerns the people in my state because of the potential for increased risk of errors or incorrect sampling of the market.

I wonder if maybe Pat Boyle, or Dr. Gilles would tell us what the plans are for that?

Mr. BOYLE. I would be happy to answer that, Senator Cochran. The proposal that we have submitted regarding the market news budget itself would not reduce the level of funding for the program. We will still be requesting about $15 million to fund the market news program nationwide. What the proposal seeks to do is shift the source of funding away from the appropriated account to a user-fee basis. In that regard, we do not anticipate a reduction in services.

Concerning the situation in Mississippi, in 1983, as part of a reduction in the appropriated amount for market news, we did have to reduce services in a number of states with which we were cooperating in providing market news services. Along with a number of other states, Mississippi experienced a $6,000 reduction in our annual contribution to that program.

The Mississippi Commissioner of Agriculture was not pleased. Since 1983 we have been able to reallocate some resources in the market news program. Last year, we reinstituted payment of an additional $6,000 for the federal/state cooperative market news effort in the state of Mississippi.

I understand that the commissioner has recently written to the department requesting additional support in this fiscal year. While I would very much like to be in a position to give him an immediate yes, I am not sure that given our own fiscal constraint at the federal level—which, of course, is shared at the state level—we are in a position to react favorably to that request.

THIRD COUNTRY MEAT DIRECTIVE

Senator COCHRAN. I understand that Senator Grassley brought up a question about the third country directive. I understand that the potential of impairing our ability to export meat into the EEC countries because of this directive is very serious. I wonder if you could tell us what your estimate is as to the impact on the meat industry in America if the EEC requirements that we hear about go into effect?

Dr. HOUSTON. We really have two problems, Senator. One is the third country meat directive, as you mention, and the other is the hormone ban; both have the potential for eliminating our exports to the Community.

With regard to the third country directive, there is a set of rules and regulations that are being applied in a number of plants who wish to continue to export to the European Community. If not properly implemented by the end of this year, those plants not in compliance will no longer be authorized to ship to the EC.

In fact, the EC, around May 1, will limit those plants which ship to Europe to probably 130 or 140 plants. If we can keep that number of plants shipping, if the Community agrees that they are in compliance with the directive, we will probably be able to maintain the export volume that we had in the past. If that number grows smaller, though, or no plants eventually survive, then we are going to lose an $80 million market that currently exists.

I am hopeful that with continuing political pressure and the technical discussions that are underway, we will be able to persuade the Community to approve enough plants so that trade deprivation will not occur. I think, however, by the end of the year if trade deprivation does occur, there will have to be some action, or there will be action taken by the administration to offset those losses, and I am in no position at this point to say what those might be.

I also mentioned the hormone ban, which will go into effect January 1, 1988, and would require us to only ship products to the Community that came from animals not treated with hormones. Since hormones are used so widely in agriculture here in the United States, it would knock out that part of the trade.

We have two very serious problems with the European Community, and unless we are able to resolve them, I think we can see a very difficult situation facing us from a trade and political level.

Senator COCHRAN. What is the potential for economic impact in dollars and cents?

Dr. HOUSTON. I think our market is about $80 million in meat exports going into the Community.

Senator COCHRAN. That would be pretty devastating.

Dr. HOUSTON. It would be. We are working very hard to try to avoid it, and so is the U.S. Trade Representative, Ambassador Yeutter. Mr. Lyng is also working very hard on it. He has been communicating with his counterparts in the European Community on these kinds of questions.

RESIDUE CONTROL PROGRAM

Senator COCHRAN. You mentioned the hormone ban, and that raised another subject in my mind. More and more attention is being given to the issue of residues in meat and poultry products. Your office is charged with the responsibility of helping assure a safe and wholesome meat and poultry supply for American consumers. Do you think your residue control program is effective?

Dr. HOUSTON. Yes, I do. I think if you look at the data that has been generated over the last several years, and also look at the market basket data that has been generated by FDA, you will see, over the last 10 to 15 years, we have achieved an improvement in the quality of our food supply as related to the appearance of residue.

There is no doubt, if we go back to the fifties, and perhaps to the sixties, that we did have some serious problems, especially with chlorinated hydrocarbons and some environmental contaminants, but I think that picture has improved dramatically.

We still have three areas, though, where we do have some residue problems that are difficult to manage, and we need improvement. One is the issue of antibiotics and sulfa drugs in young bob veal calves, and that is a difficult problem for us. We still have some problems with the issues of antibiotics in dairy cattle, especially dairy cattle that are coming to slaughter because they are no longer useful as milking animals. The third is the fact that we still have too many violations for sulfa residues in pork. We are seeing improvement in all of those areas, and we continue to place a lot of emphasis on improvement.

Senator COCHRAN. Thank you very much for your answers to my questions.

Thank you, Mr. Chairman.

FIELD INSPECTORS

Senator BURDICK. Dr. Houston, I have one remaining question, and by the way, we will be submitting questions in writing to you for response to the record.

Dr. Houston, as a requirement of the discretionary inspection, do you intend to use field inspectors?

Dr. HOUSTON. Yes, sir; we would expect that, as we implement discretionary inspection over the next year, and on into 4 or 5 years from now, we will probably be able to do inspection of processing plants with about 50 percent of the people we currently employ. We presently have 2,000 inspectors who are assigned to processing inspection. In the out-years, if properly implemented, we estimate that we would do that with 1,000 to 1,200 qualified inspectors.

Senator BURDICK. You just answered my next question. The inspectors seem to be against this discretionary inspection.

Dr. HOUSTON. Yes, sir; they are very opposed to it because it appears as a threat to them. However, throughout all the changes we have made over the last 10 years in modernizing the program, every opportunity has been given to inspectors to engage in other types of work in the agency. No one has lost their job as a result of this who are willing to relocate. Sometimes people are unable or unwilling to relocate, and some do lose their job as a result of that.

We have also made a commitment to the labor union representing our inspectors that no one will lose their job as we implement the discretionary inspection, and that the savings will be made through attrition.

Senator BURDICK. Attrition or move to another area?

Dr. HOUSTON. Yes.

Senator BURDICK. They won't lose their jobs.

Dr. HOUSTON. We have made that commitment to the labor union.

SUBMITTED QUESTIONS

Senator BURDICK. Thank you, gentlemen. Additional questions will be submitted for the record, and they will come from myself, Senator Grassley, Senator Bumpers, Senator Sasser, Senator McClure, and Senator Kasten. I would appreciate your responding to them in writing for the record in an expeditious manner.

[The following questions were not asked at the hearing but were submitted for response for the record:]

AGRICULTURAL MARKETING SERVICE

QUESTIONS SUBMITTED BY SENATOR BURDICK

PROMOTION PROGRAMS

Question: Three promotion programs were adopted as part of the Food Security Act of 1985. They relate to improving the domestic and international marketing of Beef, Pork, and Watermelons. What is the amount of assessments collected on each from these programs?

Answer: Assessments for domestic beef for the first 4 months of the program, October 1, 1986, to January 31, 1987, totaled $17.2 million, while assessments for imported beef for that same period totaled $1.6 million.

Assessments for domestic pork for the first 4 months of the program, November 1, 1986, to February 28, 1987, totaled about $6.2 million, while assessments for pork imports for that same period totaled approximately $400,000.

No assessments have been collected to date for the watermelon research and promotion program because the program is still in the promulgation stage. Hearings for the Watermelon Program were completed on February 25, 1987. The recommended decision will be issued in December 1987.

PLANT VARIETY PROTECTION

Question: How are these fees currently invested?

Answer: Funds currently collected for services performed under the Plant Variety Protection Act are not invested by AMS. These funds are returned to the Treasury as miscellaneous receipts.

Question: In Fiscal Year 1988, what is the level of funds that AMS would receive under its proposal to retain revenues charged to plant developers certifying seed under the Plant Variety Protection Act?

Answer: In Fiscal Year 1988, we anticipate $350,000 in revenue from plant developers.

Question: How would these funds be used to offset AMS expenses?

Answer: Funds received for researching plant variety applications and issuing certificates would be used to pay salaries, benefits and other incidental expenses necessary to provide this service. All AMS expenses would be covered by these fees.

EGG PRODUCTS INSPECTION

Question: Among the legislation proposed by the Administration is a sharp reduction in the current continuous in-plant inspection of egg processing and the imposition of user fees to recover inspection and surveillance services costs. Would this amount be collected in fees assessed on egg handlers in fiscal year 1988?

Answer: Under current legislation, Egg Products Inspection Act costs, other than overtime and holiday pay, are paid from appropriated funds. Consequently, for basic inspection service, there is no direct cost to egg handlers. If only the less-than-continuous in-plant inspection legislation is implemented, the resulting savings would reduce our need for appropriated funds. If both less-than-continuous in-plant inspection and user fee legislation are implemented, the resulting savings from less-than-continuous inspection would be applied to egg breaking and drying plants, egg packers and hatcheries at fee levels lower than those required to fund the current level of continuous inspection.

Question: How could the American public be assured that they were receiving wholesome, unadulterated, and accurately-labeled egg products without continuous inspection and surveillance activities?

Answer: Consumers will continue to receive wholesome, unadulterated and accurately labeled egg products if this legislative proposal is enacted. Less-than-continuous inspection would apply only to egg processing plants where they process eggs and egg materials that were certified wholesome by continuous inspection at egg breaking plants. In addition, we will use discretion in terms of implementing less-than-continuous in-plant inspection. The past history of a plant's compliance with the Egg Products Inspection Act regulations will be a primary criteria in determining the intensity of inspection in each plant.

INSPECTION AND STANDARDIZATION

Question: The Agricultural Marketing Service estimate for fiscal year 1988 includes a reduction of $218,000 in inspection and standardization activities. What type of specific administrative reductions do you expect will be required to absorb this cutback in funds?

Answer: These reductions can be achieved by delaying equipment purchases and reducing travel and by other short-term measures.

Question: Considering the range of agricultural commodities that are subject to inspection and standardization, would you expect that certain commodities would take priority over others, or would you reduce inspection and standardization activities across-the-board?

Answer: The administrative savings which we propose to absorb will not result in service reductions for any commodities.

FEDERAL SEED ACT

Question: In the 99th Congress, the Administration proposed to terminate the Federal Seed Act. This year, the Administration proposes user fees for recovery of Federal regulatory costs associated with enforcement of seed labeling requirments under the Federal Seed Act. What is the current costs of administering the Federal Seed Act?

Answer: The annual Federal Seed Act budget is currently $977,000.

Question: How would the Administration's user fee proposal be imposed?

Answer: Firms shipping seed in interstate commerce would apply to the Department for a license, stating on the application the dollar value of the firm's interstate sales for the previous year. An assessment based on the value of interstate sales will be payable with the application.

Question: Would this proposal discourage interstate trade involving agricultural and vegetable seeds in any manner?

Answer: We feel that this proposal will not discourage interstate trade in seeds.

Question: Would licensing requirements discourage interstate commerce?

Answer: Licensing requirements should have minimal impact on interstate commerce.

Question: Are you familiar with the number of violations of the Federal Seed Act that have occurred in the past five years?

Answer: Yes, there have been 4,456 violations of the Federal Seed Act in the past five years. In FY 1986, 583 new complaints were received from 29 States. Approximately 25 percent of all complaints turned over to AMS for investigation warranted penalty action.

MARKETING AGREEMENTS AND ORDERS

Question: The Administration proposes to recover the costs of carrying out Federal marketing agreements and orders for an estimated savings of more than $7.7 million in fiscal year 1988. How would this recovery of costs be implemented?

Answer: Two methods for determining the amount of assessment for the market administrators and local governing committees are currently being considered. The first method would be to assess fees based on the volume of milk marketed, the value of fruit and vegetables marketed, and the volume of eggs marketed for the egg marketing order, which is expected to be in effect for FY 1988.

The second method would base fees on the annual budget of the market administrator or local governing committee for milk, egg, and fruit and vegetable marketing orders.

The assessments would be collected by the market administrators and local governing committees of the various marketing orders. Because the market administrators and committees currently collect assessments to cover their costs, the collection of additional sums to fund the Federal portion of the costs would impose little additional administrative cost and burden.

Question: What is the current level of expenses of marketing administrators and committees that are financed through assessments on regulated handlers and producers?

Answer: The annual budget for the milk market administrators is $34,145,700 and $6,634,000 for the fruit and vegetable committees.

Question: If the Administration's proposal were adopted, what specific types of services would these new funds cover?

Answer: Such funding would cover the cost of overseeing the administration of the orders, including establishing and amending the orders through public hearings and enforcement of the orders.

Question: The Workload Data on marketing agreements and orders provided by the Department indicates that an estimated 50 administrative committees will be appointed in fiscal year 1988. How many marketing agreements or orders were terminated in fiscal year 1986 and 1987? For what programs?

Answer: No marketing agreements and orders were terminated in fiscal year 1986. For fiscal year 1987, two fruit and vegetable marketing orders will be terminated and one milk market order will be merged with another. These orders include the hop marketing order which was terminated in October, 1986, the tart cherries marketing order which will be terminated on April 30, 1987, and the Fort Smith, Arkansas Federal milk order which will be merged into the Southwest Plains order effective May 1, 1987.

Question: Will these orders be reconstituted in fiscal year 1988?

Answer: There are no plans to implement these orders again.

Question: For what producers will administrative committees be established in fiscal year 1988? What two of these were not appointed in fiscal year 1987?

Answer: A marketing order and an administrative committee for the order is anticipated for strawberries in fiscal year 1988. There are also plans for marketing orders for Vidalia onions, Texas-New Mexico Irish potatoes, and European greenhouse cucumbers. It has not been determined which of the proposed marketing orders will be established in fiscal year 1987. Each order will have an administrative committee established.

Question: Enforcement of marketing order violations has been particularly troublesome to producers and handlers who comply with regulations. Does the Department have plans to improve enforcement of violations in fiscal year 1988?

Answer: Plans to improve enforcement of marketing order violations are currently underway in AMS. Compliance officers have been and will continue to provide assistance to the marketing order administrative committees in the enforcement of marketing orders. This assistance includes on-site training of Committee personnel in such areas as case documentation and the procedural steps involved in the enforcement process.

Question: Will penalties be imposed?

Answer: Penalties for order violations will be imposed appropriately according to the nature of the violation. With the added emphasis in enforcement, it is expected that in the short term, more penalties will be imposed. In addition, penalties for some order violations will be increased from a minimum of $50 and a maximum of $500 to a minimum of $500 and a maximum of $5,000.

Question: Over the past few years, the Administration's policy with respect to the continuation of marketing agreements and orders has changed substantially. Would you please state the reasons for this policy shift and provide an explanation of the Administration's current position on whether marketing agreements and orders should be continued?

Answer: The Administration recognizes the need for marketing agreements and orders to reduce extreme fluctuations in supplies and prices, and thereby reduce risks to both buyers and sellers and provide protection against extreme losses arising from economic and natural causes. The Secretary, however, plans to require some adjustments in programs that restrict entry, limit supply, or perpetuate over-supply of commodities.

Several types of marketing agreements and orders are currently administered by the Department, including producer allotment programs, marketing allocation programs, and prorate programs.

Recent review has shown that producer allotment programs have the potential for limiting supply, causing under-investment by industry, and reducing open competition by restricting entry of new producers. While the allotment system is contrary to the general policy of this Administration, it does have a statutory basis. To balance policy goals with statutory requirements, the Secretary will carry out these programs in a manner that will eliminate barriers to entry. Where changes in existing programs are necessary, the Secretary will work with the affected industries toward gradual adjustments.

The Secretary recognizes that market allocation programs can be beneficial to producers when used properly. The program must allow individual incentive and product innovation; additionally, such programs should not be used to inhibit long-run market expansion or to encourage or to continue chronic over-production. The Secretary intends to evaluate annually the economic situation in each industry where market allocations are proposed to ensure that regulations are designed with these objectives in mind.

This Administration believes that prorates can be a viable tool for effective marketing serving the interests of both producers and consumers through market stabilization and extension of the season. This type of program may be used to prevent temporary market gluts and correspondingly depressed prices by smoothing out product flow. It contributes to more efficient use of handling and distribution facilities. However, maximum effectiveness would require "perfect" market information and administration. All too often one or both of these are unattainable. Consequently, prorates should be used guardedly so as to avoid stifling individual incentive or overly restricting market supplies.

PAYMENTS TO STATES

Question: The Administration's fiscal year 1988 budget deletes $942,000 in funds used to form cooperatives with State Departments of Agriculture for joint enterprises that will improve and encourage new marketing techniques for agricultural commodities.

Although $942,000 has been appropriated in FY 1987, none of these funds has been obligated. Please tell the Committee whether State projects have received their commitments for these funds at this time.

Answer: As of March 18, there are sixteen projects on hand for consideration. At this point, none have been approved. However, recommendations for 1987 grants will be made in the near future.

Question: With the anticipated increase in sunflower production in North Dakota, marketing information is important to producers. What is the current status of the sunflower marketing project?

Answer: The North Dakota Federal State Marketing Improvement Program grant supports the Sunflower Information Project by contributing to the activities of the National Sunflower Association. The Association primarily offers market information and intelligence to 20,000 sunflower producers in the United States so that they may make rational marketing decisions. This is accomplished through periodic publications, marketing seminars and a recorded telephone message offering daily price information.

Question: Alternative crop handbooks were developed in conjunction with the Nebraska Department of Agriculture. What is the status of this project?

Answer: The Nebraska Agricultural Products Diversion Project is now well underway. It is our understanding that the alternative crops handbook is being prepared at this time. Also, plans for demonstration areas in several sections of the State are being made. Work on this project also has included technical assistance to a vegetable marketing cooperative. This project was awarded $120,000 for two years out of FY 1986 funds, with grants to be paid in eight quarterly installments.

Question: What level of funds will be obligated for this project in FY 1987?

Answer: Half of the funding obligated from FY 1986 appropriations will be used on this project in FY 1987. There has been no request for additional funding.

Question: The Upper Mississippi River Region States would benefit by recommendations of USDA's study of river transportation being conducted in Iowa. Please explain the findings of this study and whether proposed improvements are underway in this region.

Answer: The Upper Mississippi River Transportation Economic Study is a two year project involving matching funds from five States--Minnesota, Wisconsin, Iowa, Illinois, and Missouri, with Iowa assuming the primary administrative responsibility. This study is a detailed assessment of the components of waterway operation and an evaluation of managerial, informational, engineering, and other non-structural improvements and low-cost actions to increase the efficiency of water transport. A report on the study findings is scheduled for April 1988 with implementation anticipated thereafter.

MARKET NEWS ACTIVITIES

Question: The budget estimate for AMS for fiscal year 1988 based on current law, includes a decrease of $244,000 for Market News Activities. Several activities carried out by the Market News Service require ongoing data collection, integration of information, and dissemination of reports. Would you please explain how you would expect this funding decrease to be absorbed by the Market News Service without inhibiting ongoing activities?

Answer: In the short run, administrative savings such as delayed equipment purchases, and reduced travel can be made without impairing program delivery.

Question: What is the status of your work with the University of Florida to increase the efficiency of the AMS reporting system?

Answer: A cooperative agreement has been initiated with the University of Florida to study the feasibility of developing a more efficient and complete USDA market reporting system. Phase I of this study will describe the operations and procedures of each of the segments of the market news service, identify common elements, and define their overall objectives and information requirements. Phase II will determine alternative systems that effectively satisfy these requirements and estimate costs and benefits for each of the selected alternatives.

A draft of the first part of Phase I has been received. The feasibility study is expected to be completed and a final report submitted to AMS near the end of FY 1987.

Question: The Administration proposes legislation to impose user fees for services provided by the Federal Market News Program estimated to save $15.4 million in Federal funds in fiscal year 1988. Please explain the Administration proposal to recoup costs of certain market news activities through a mandatory assessment on the first handler of a respective commodity.

Answer: Since the first handler of the commodity has direct contact with the producer, the first handler is proposed to act as the collection agent.

For Cotton, first handlers are cotton gins and cotton futures exchanges. Dairy first handlers are the persons--individual, group, partnership, corporation, association, cooperative or other entity--who pay producers for the producers' raw milk marketings. First handlers for fruits and vegetables are shippers or commission merchants that handle a producer's first sale. Livestock first handlers include order buyers, packer buyers, dealers, auction markets, and terminal markets. First handlers for grain include country elevators, unit train loading points, export facilities, feed mills, flour mills, and other grain processors. For poultry, first handlers are slaughtering plants. Shell egg packing plants and egg breaking plants are considered first handlers for eggs. Tobacco first handlers are the approximately 550 auction warehouse firms operating on 150 designated auction markets.

Question: What is the amount you would expect to collect in this manner?

Answer: Fees would have to be set such that AMS would recover the funds needed to continue the Market News Program. The total costs estimated for fiscal year 1988 are approximately $15.4 million.

Question: In addition, the Administration's legislation would require fees from persons receiving published information on marketing conditions and various commodities. What is the estimated amount of fees to be collected under this proposal in fiscal year 1988?

Answer: The estimated amount of fees needed to cover the costs of postage, printing, and handling for cotton and tobacco printed reports is $313,000. Existing fees for dairy, fruit and vegetable, livestock and grain, poultry, and egg printed reports, which have been in effect since FY 1982, will not be affected by this legislative change.

Question: How would the Administration's user fee proposal affect the quality and quantity of information on market conditions for the full range of commodities AMS covers?

Answer: The quality and quantity of information on market conditions is not affected by conversion to a fee basis for printed reports. However, conversion to user fees generally results in decreased demand for printed reports because market news printed reports generally provide historical rather than current decision-making information. The same information is available through other, more timely, less costly methods of dissemination.

Question: In fact, isn't the fee on recipients of information optional because they could decide not to receive the information?

Answer: Receipt of printed market news reports is optional. AMS currently charges fees for printed market news reports on all commodities except cotton and tobacco. A fee for printed cotton reports will be implemented in October 1987 and legislation is being proposed which will permit us to charge fees for tobacco market news reports. Fees for printed reports cover the costs of handling, printing, and mailing and therefore would continue to be charged separately from the fees for the remainder of the program.

Question: Is it possible that, because of the optionality of this fee, you wouldn't take in as much money as planned?

Answer: Because the demand for a free product is generally higher than a product with a cost, we anticipate some drop in demand for printed cotton and tobacco market news reports.

Question: If the full $15.4 million were not recouped through the various collection proposals, how would AMS fund the market news service to assure that quality market news information on various commodities continues to be accessible?

Answer: Because assessments on first handlers will be mandatory, the fee charged for data collection, analyses, and dissemination of information will be adequate to recover all costs of the program.

POTATO STANDARDS

Question: The Food Security Act of 1985 included a provision to assure quality standards of potatoes marketed in the U.S. The Act requires that random spot checks be conducted on imported potatoes to assure that quality standards are maintained. Would you please tell the committee whether or not AMS has implemented this provision, and what the results of these inspections have been?

Answer: Yes, AMS has implemented this provision. Only a small percentage of potatoes-- .25 percent-- have failed to meet minimum quality standards at the destination.

HORTICULTURE PRODUCERS FEDERATION

Question: The Senate Appropriations Committee Report (S. Report No. 99-438), directed the Agricultural Marketing Service to assist the Horticulture Producers Federation in implementing a marketing program. Would you please provide for the record the activities of AMS relative to the 14 marketing cooperatives of the Horticultural Producers Federation?

Answer: We have participated in three cooperative agreements over several fiscal years to help the Horticultural Producers Federation and the fourteen marketing cooperatives.

AMS, Tennessee Valley Authority, and the Virginia Polytechnic Institute and State University have assisted the Federation in acquiring computers and developing software for exchanging market information between cooperatives and in recordkeeping. We also conducted a market study in the Southeast and are assisting in the publication and distribution of a monthly newsletter for the member cooperatives.

AMS is assisting the Federation in standardizing vegetable packs and packaging material and initiating centralized marketing among the cooperatives. The Southeastern market study revealed that some wholesale buyers have not been satisfied with the consistency of the quality of products from some Federation members in the past. AMS researchers have analyzed this problem and recommendations have been presented to the Federation.

AMS personnel have analyzed the facilities, equipment and handling methods at five of the cooperatives and developed recommendations for improvements. Additional analyses will be conducted for these and some of the other Federation members during the 1987 season.

Additionally, a market development specialist position was created and filled on the Federation staff to help member cooperatives expand current markets and penetrate new ones.

Question: What is the amount of funding allocated to this marketing program?

Answer: Fiscal year 1986 obligations totaled $100,000 and are planned to be expanded over a 2-year period which includes fiscal year 1987.

MARKET OPPORTUNITIES FOR FRESH PRODUCE

Question: During FY 1987, the Agricultural Marketing Service assessed market opportunities and the need for facilities for fresh produce and for technical assistance for market development in several States. Please provide the Committee with your findings.

Answer: During FY 1987, AMS specialists conducted studies of wholesale food distribution and farmers' markets in Buffalo and Syracuse, New York, the Maryland Wholesale Food Center at Jessup, Maryland, and facility needs for fresh produce in northeastern Mississippi. Technical assistance was also provided for market development in North Carolina, Virginia, and Massachusetts. Preliminary findings have been completed outlining a potential new combined wholesale and farmers' market facility. In cooperation with the Virginia Department of Agriculture and Consumer Services, plans have been developed for prototype facilities on a series of State wholesale/farmers' markets at various locations in the State. Technical assistance continues in the development of a new $14 million combined wholesale/ farmers' market in Raleigh, North Carolina; the ground breaking for the new market was held on March 2, 1987. Other technical assistance was provided to the Massachusetts Department of Agriculture concerning modern facility designs and farmers' market development in Worcester, Massachusetts.

MARKETWIDE SERVICE PAYMENTS

Question: Section 133 of the Food Security Act of 1985 requires the Secretary to hold hearings and to render a decision on proposals for marketwide service payments. In the event such payments are ordered: What steps have been undertaken to increase the staff of marketing administrators in the affected market order areas to control and supervise such payments?

Answer: Amendments have been proposed by the industry and hearings have been held. AMS is now analyzing the hearing record and will issue a recommended desision in the future. If marketwide service payments are recommended by the Secretary, little, if any, additional staff would be needed to administer such provisions since the current staff of the market administrators is capable of handling the increase in workload.

Question: Do you consider the type of reports furnished by recipients of payments in the New York area to be adequate to identify who received payments, the service provided, and the marketwide benefit to dairy farmers?

Answer: The reports are adequate to identify those entitled to receive payments and the services provided. The reports are neither designed nor intended to measure the marketwide benefit to dairy farmers. Whether a particular service is of benefit to all dairy farmers in a market is an issue that would be decided on the basis of a public hearing. Only those services considered to be of marketwide benefit would be included in an order for the purpose of reimbursing the providers of the service. The market administrator's role would be to determine which organizations meet the specified criteria for receiving the payments, and to make the payments as provided in the order. Through audits of reported data and the examination of books and records of handlers, the market administrator would verify that the services had been performed and that the recipients were entitled to payment.

Question: Should the marketing administrators be empowered to investigate payments and employ auditors to examine books and records of those receiving payments?

Answer: The market administrators already have the necessary authority and auditing capability to verify payments for marketwide services that may be provided for in any Federal milk order.

Question: What methods do you envision that market administrators will use to determine the marketwide benefit of claimed services? What services were needed and what services were provided?

Answer: Market administrators would base their determination of services provided by audit of reports filed by those who collect payments and through an examination of their books and records. The determination of which services should be subject to reimbursement and whether the services are of marketwide benefit would be issues for consideration at public hearings on proposals to adopt payments for marketwide services.

Question: What procedures will market administrators use to monitor the impact of reduced milk prices, due to milk pool payments for services, on nonmember dairy farmers and on their cooperatives and independent handlers?

Answer: Market administrators would be sensitive to changes in numbers of cooperative members and nonmembers. They also would watch for shifts of producers among organizations and from markets having payments for marketwide services to those that do not. Although the market administrators would be alert to any developing problems, changes in the orders to address those problems normally would be made through the public hearing procedure. In some cases, situations could be dealt with by the Secretary through a suspension or termination of order provisions.

Question: Are independent dairy farmers being compelled by the size of the payments to involuntarily join dominant regional cooperatives?

Answer: Our basic experience concerning the impact of payments for marketwide services has been limited to the 3 cents per hundredweight payment to cooperatives under the New York-New Jersey Federal order. This payment, which has been in effect for many years, is relatively small and probably has had little influence on whether producers join cooperatives. It should be noted that the New York-New Jersey market for several years has ranked among the lowest in the Federal order system in terms of the percentage of producers who are members of dairy cooperatives.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

BIENNIAL BUDGET

Question: Would your department/agency favor a biennial budget process? What benefits would your agency achieve in a two-year appropriation cycle?

Answer: Assuming procedures are established to assure that funding needs occurring in an off budget year are adequately handled, the Agricultural Marketing Service would not be opposed to the concept of a biennial budget.

The advantages of a biennial budget include the establishment of multi-year plans for our various programs; stability for several of our programs which are historically proposed for elimination but continually restored by Congress; and a reduction in the amount of time required to formulate and submit the budget.

Question: Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer: Currently, only 25% of the AMS budget is appropriation supported. Over the past several years, AMS' appropriation request has consisted largely of program eliminations and converting programs from an appropriated to a user fee basis. Those program and legislative changes not approved by Congress in the preceding year are usually resubmitted to Congress with some change each year. Seventy-five percent of AMS' funding is derived from user fees which are not usually submitted for reductions or legislative changes. Any savings resulting from a biennial budget submission would be negligible in the AMS budget function because most of our attention is devoted to analyzing user fee levels, managing an investment program, ensuring adequate cost control in our fee-supported programs, and in maintaining a timely flow of management and accounting information to program managers.

Question: What difficulties can you foresee in preparing and submitting a two-year budget to the Congress?

Answer: The most difficult aspect would be accurately forecasting program needs for a two year period, including the costs to offset increased operating expenses. In addition, it is unclear how our permanent annual appropriation for Section 32, which is based on Custom's receipts, would be handled since receipts vary from year to year. In conjunction with this, it would be difficult to determine the amount of funds needed to replenish the unobligated balance in Section 32 which is used for emergency surplus removal activities. Other potential problems include the need to adjust the administrative limitation on our user funded activities because of increased requests for grading services, and lastly, how legislative changes and increased Agency responsibilities can be accommodated in an off budget year.

FEDERAL GRAIN INSPECTION SERVICE

QUESTIONS SUBMITTED BY SENATOR BURDICK

SUPPLEMENTAL APPROPRIATION

Question: You indicate that you have a $2 million balance of the $6 million supplemental appropriation FGIS received in fiscal year 1984. What do you expect the balance to be at the end of fiscal year 1987?

Answer: The FGIS inspection and weighing services revolving fund experienced a large loss for fiscal year 1986. This loss reversed a pattern of operating profits for fiscal years 1984 and 1985 and repayment was not made in fiscal year 1986. Because of this loss, the $2.0 million balance of the $6 million FGIS received in November of 1983 will be repaid in fiscal year 1987 if operating balances permit.

Question: How has this fund been used and replenished since it was provided?

Answer: In fiscal year 1984, the $6 million supplemental was appropriated to recapitalize the FGIS inspection and weighing services revolving fund. We have always considered this supplemental appropriation to be a line of credit, to be used only when necessary. Since FGIS was able to maintain its desired three month operating reserve, a repayment of $2 million was subsequently made to the Treasury in fiscal year 1984 and fiscal year 1985. The funds therefore have not been used and we plan to repay the remaining $2 million if operating balances permit. No additional appropriated funds are anticipated.

GRAIN QUALITY IMPROVEMENT ACT OF 1986

Question: The Grain Quality Improvement Act of 1986 was recently enacted and prohibits the recombination of the dockage and material that was removed from grain, the addition of dockage (or foreign material) to grain, and the reintroduction of dust to grain that was previously removed. This law is scheduled to become effective on May 1, 1987. Have you proposed regulations at this point?

Answer: Yes. Proposed regulations on grain handling were published in the Federal Register on March 13, 1987. Proposed changes to the insect standards were published in the Federal Register on March 18, 1987. On February 10, 1987, comments were requested on the optimal grain grading concept.

Question: What type of public comment are you requesting on this new law?

Answer: Through the Federal Register we are inviting comments from all interested persons. This includes domestic users, exporters, and importers of U.S. grain.

Question: You also indicate in your testimony that the requirements of the new law will place added responsibility on your agency and that this responsibility is cause for concern. What are the anticipated extra costs that would be required?

Answer: Most of the additional costs will be associated with monitoring and regulatory activities. These extra costs have not been fully determined.

Question: Do you intend to ask for additional funding for fiscal year 1987 in order to carry out this new law?

Answer: No, we do not intend to ask for additional funding for fiscal year 1987.

USER FEES

Question: Your statement indicates that FGIS increased fees by 17 to 42 percent for official inspection and weighing services on January 5, 1987. Please explain under what authority this was done.

Answer: The authority that permits FGIS to charge fees is the "U.S. Grain Standards Act," as amended (7 USC 79), Section 7(j)1 which states "....the Administrator may prescribe, charge and collect reasonable inspection fees to cover the estimated cost to the service incident to the performance of official inspections...."

Question: Why does the range vary from 17 to 42 percent?

Answer: FGIS strives to have its various programs financially self-supporting and maintain a three month operating reserve. FGIS maintains separate profit and loss accounts for each of its various programs. The financial condition of these programs is in turn based on workload activity. Since each account has a different profit and loss level, the fee increases varied from 17 to 42 percent.

Question: How much additional revenue will this bring into the agency?

Answer: The fee increase is estimated to bring approximately $2.4 million annually in additional revenue above the fiscal year 1986 level. However, since the user fee increase became effective on January 1, 1987, we will only recover three-fourths or $1.8 million during fiscal year 1987.

Question: Do all of the revenues gained from user fees go toward FGIS activities?

Answer: Yes, all revenues gained from the user fees go toward FGIS' activities.

Question: You propose to implement user fees which would cover 100 percent of your programs and indicate that some of the direct beneficiaries are the producers and merchandisers. Can you identify the groups that will be charged the additional user fees?

Answer: The groups that will be charged the additional user fees are the applicants for official inspection and weighing services. Some of these costs will eventually be paid by the direct beneficiaries such as the producers, merchandisers, and others who participate in the marketing of U.S. grains and related commodities.

Question: Are they currently paying some user fees and, if so, what kind of an increase will the proposed legislation mean for them?

Answer: Yes, the same applicants for services that are currently paying user fees for FGIS services will be charged the additional fees. The average increase in user fees is estimated to be approximately 18 percent.

WHEAT CLASSIFICATION

Question: I understand that FGIS is looking into the problem of wheat classification. With recent advancements in genetics and breeding, some of the wheat classes are beginning to look like each other. What is FGIS proposing in this area?

Answer: The search for objective means of classing is proceeding on a national basis. The Wheat Classification Working Group consisting of scientists from industry, academia, and government are exploring what instruments or testing procedures might be used to classify wheats. Collaborative testing and an evaluation of samples supplied by the flour milling industry are presently in progress as a result of this search. A report of this work is due FGIS in July 1987.

FGIS has been pursuing single kernel hardness as a means of separating soft and hard wheats. This procedure cannot be used to separate the spring and winter classes. Hardness instrumentation developed by the Agricultural Research Service--ARS--in Beltsville, Maryland, is being evaluated by FGIS. Instrumentation from ARS in Manhattan, Kansas, and the Kansas State University in Manhattan, Kansas, is expected to be available this summer for evaluation by FGIS. To this point, FGIS believes separation of soft and hard classes by individual kernel analyses is the only viable procedure available. Near infrared reflectance technique can be used on bulk samples for the same purpose without a capability for detecting low levels of blends of hard and soft wheats.

GRAIN QUALITY

Question: My office continues to receive complaints from farmers who say that the grain is clean and of high quality when it leaves their farms but is dirty and, therefore, of low quality when it reaches its final destination abroad. Will the new law put these complaints to rest?

Answer: It is very doubtful. Farmers believe their grain is of top quality and expect top dollar for it at the local elevators even though many times it may be of lower quality than they expect. Farmers often judge the quality of their grain by visual appearance and not by the actual factor analysis. Many small country elevators do not perform actual factor analysis on the farmers' grain coming into the elevator.

Question: What is the basis for these complaints?

Answer: Many factors contribute to the perceived quality of grain. Mixing and blending of grain, a key element in the marketing chain, begins at the farm and is practiced throughout the marketing chain to produce an acceptable level of uniformity in the grain.

The receiver may, also, have a preconceived concept of what the grain will look like. When the buyer receives the grain shipment and unloads it, the grain sometimes does not look like what the buyer thought it should look like. The phenomenon of grain particle segregation during handling, improper sampling, and the "boiling effect" of grain loading results in the light weight material rising to the surface. Much of it remains there and is the first thing the buyer sees when the hatch of a vessel is opened giving the perception that the grain is of a lower quality than was ordered.

GENERAL

Question: For fiscal year 1986, the amount available for inspection and weighing services was $35,244,000. However, according to your explanatory notes, the actual collections for fiscal year 1986 were $27,506,836. Furthermore, your explanatory notes for fiscal year 1987 showed that you estimated the 1986 amount would be $36,829,000. Please explain the difference between the fiscal year 1986 estimated level and the fiscal year 1986 actual level.

Answer: During fiscal year 1986, FGIS obligated $29,902,000 in its inspection and weighing services revolving fund. This was $6,927,000 less than the fiscal year 1986 estimated amount of $36,829,000. The estimated amount represents an authorized spending ceiling. Establishing the somewhat high ceiling is done to allow for wide fluctuations in the volume of grain exported which in turn would cause the actual expenditure level to fluctuate. A ceiling too close to the actual expenditures would not be prudent as FGIS legally would be unable to obligate funds that exceeded this ceiling. Under the provisions of the U.S. Grain Standards Act all grain exported, with minor exceptions, musc be officially inspected and weighed. Theoretically all grain exports would have to cease when actual expenditures reached the authorized spending ceiling.

Question: Can we expect a similar difference for fiscal year 1987?

Answer: Yes, we wish to keep the ceiling somewhat higher than the anticipated actual expenditures level to allow for fluctuations in the level of U.S. grain exports. Although the level of U.S. grain exports has been low during recent years, the margin between the authorized ceiling and the actual expenditures has not always been this wide.

WHEAT STANDARDS

Question: FGIS revised the U.S. wheat standards requiring that wheat dockage be certified to the nearest 1/10th percent and that wheat protein be certificated based on the constant 12.0 percent moisture. These changes were made only a few months ago and they will become effective on May 1, 1987. What benefits do you expect as a result of these changes?

Answer: The current method of dockage certification rounds the actual dockage percentage down to the nearest half or whole percent. This method may result in understating the level of dockage up to 0.49 percent on the certificate. Certification of dockage to the nearest 0.1 percent is more precise than the current method. The elimination of the problem of understated dockage will strengthen the credibility of the official inspection certificate, enhance buyer confidence in the U.S. Standards for Wheat, and strengthen the competitive position of U.S. wheat in the world market.

The certification of wheat protein on a constant 12.0 percent moisture basis will provide uniformity to the certification procedure. Based upon information available to FGIS this percentage is representative of the approximate average moisture content of wheat exported from the United States.

When reported on an "as is" moisture basis, as now is the case, the protein quantity of wheat which has different moisture levels cannot be easily compared. Protein content is inversely related to moisture content. Protein quantity certificated on a constant moisture basis of 12.0 percent will provide buyers, sellers, and users of U.S. wheat with results which can be easily evaluated and compared. Also, use of a constant moisture basis will conform with protein reporting procedures used by other major wheat exporting countries.

Question: What differences in marketing will this mean for the U.S. farmer?

Answer: Farmers who presently deliver clean wheat subsidize the price received by those who deliver a higher-than-average dockage content when an elevator purchases wheat on a station-average basis. Certification of dockage to the nearest 0.1 percent will provide elevator operators with a greater incentive to measure dockage on inbound wheat and assess a cleaning charge on high dockage lots. The extent to which individual producers are impacted as a result of certifying in increments of 0.1 percent will depend upon the competitiveness of the local market where the producer delivers wheat. The economic well-being of producers who deliver clean wheat to market should not be adversely affected.

Certification of wheat protein on a constant 12.0 percent moisture basis may affect premiums/discounts to producers. Adjustment of protein premium/discount schedules by the country elevator will depend, to a great extent, on how foreign buyers react to the change, particularly regarding export contract specifications. Consequently, benefits to producers cannot be evaluated until foreign buyer reaction is more apparent. Foreign buyers supported changing protein certification to a 12.0 percent moisture basis; therefore, the change is expected to add credibility to U.S. wheat.

Question: How about for the country elevator?

Answer: Certification of dockage to the nearest 0.1 percent would alter decision making with respect to cleaning at country elevators. The value of dockage as a feed ingredient at the local level, the transportation cost to market, the cost of cleaning, and the dockage content of individual lots are the key variables in the cleaning decision. The marketing strategies of elevator operators may range from cleaning everything to cleaning nothing. Some may clean only the lots that contain excessive dockage.

Certifying protein on a constant moisture basis--12.0 percent--will allow direct protein comparisons between lots of widely different moisture levels. Benefits to country elevators of protein certification on a 12.0 percent moisture basis cannot be evaluated until foreign buyer reaction becomes apparent.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

BIENNIAL BUDGET

Question: Would your department/agency favor a biennial budget process? What benefits would your agency achieve in a two-year appropriation cycle?

Answer: A biennial budget cycle would benefit the Federal Grain Inspection Service (FGIS). With approximately 85 percent of the agency's funds derived from user fees levied for grain inspection and weighing services, the FGIS is not heavily dependent on the Federal budget process for its operating funds. A biennial budget cycle would provide continuity for FGIS research contracts which are most often multi-year in nature. FGIS would therefore favor the biennial budget process.

Question: Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer: The FGIS receives its funding from the Congress in one appropriation account. Fixed costs (salaries, benefits, utilities, etc.) comprise approximately 90 percent of the FGIS appropriated fund request of approximately $7 million. These funds are most always repetitious of the previous year's submission. Funding needs for these programs are relatively predictable and could be handled on a two-year basis.

Question: What difficulties can you foresee in preparing and submitting a two-year budget to the Congress?

Answer: Since the FGIS appropriated programs are relatively predictable, we do not foresee difficulty in submitting a two-year budget to the Congress.

Question: If you oppose the biennial budget concept, please give this subcommittee your reasons why.

Answer: The FGIS does not oppose a two-year budget cycle.

FOOD SAFETY AND INSPECTION SERVICE

QUESTIONS SUBMITTED BY SENATOR BURDICK

SALMONELLA

Question: Does the high incidence of salmonella in poultry call into question the state of our poultry inspection in this country?

Answer: The incidence of salmonella in poultry has always been high. Earlier USDA surveys confirm this: in 1979, an agency survey found the incidence to be about 37 percent.

Elimination of the bacteria in the broiler production system is virtually impossible with present techniques and available equipment. It is also clear that testing for the presence of the bacteria and condemnation of all carcasses where it is present would be prohibitively expensive. Therefore FSIS has been focusing its efforts on control of the microorganism: minimizing its spread in the packing plant; inhibiting its growth in carcasses; and publicizing safe cooking, handling, and storing by food handlers and the public.

Question: What do you intend to do about this situation?

Answer: Since 1981, salmonella control has been FSIS' first research priority in our requests for scientific assistance from the Agricultural Research Service. This effort has yielded some progress toward control methods for the bacteria in the slaughterhouse. Carcass washing methods using warm acetic acid are one of these, and the agency will be testing these extensively during 1987. This year FSIS will also begin an extensive survey on microbial contamination of broilers. We soon will issue a proposed regulation which will offer labeling and advertising incentives to packers who apply a strong inplant system for microbiological control. The agency is working with the National Broiler Council to develop and implement industry-wide procedures to reduce the incidence of salmonella in broilers. Finally, the agency is continuing its participation in a joint federal program seeking to improve public awareness of the possible presence of salmonella in food and to reduce the presence of the bacteria in foods of animal or bird origin.

Question: You have indicated that the National Academy of Sciences report will give you the needed ammunition to effect legislative changes. What are the changes you envision, and how will they help to control this problem?

Answer: In September 1985 we contracted with the National Academy of Sciences for a study to determine whether bird by bird inspection, as required by law, is the best way to carry out poultry inspection. We expect to receive their findings this April. We requested this study as there is reason to believe that there may be more effective ways of inspecting poultry then by looking at every bird on a fast moving processing line. Birds are raised today in flocks with a common environment and feeding, and it is possible to evaluate the general health of the birds by sampling individuals in the flock, and either passing the entire flock if no problems are found, or if problems are found, then going to bird by bird inspection of the whole flock.

The question of whether we should inspect every bird is a sensitive issue and we felt that it would be valuable to get an objective opinion by authoritative outside scientific expertise on the feasibility of the flock testing concept. For this reason we asked NAS to undertake the study. If the NAS report indicates that inspection results as good as those attained under the bird by bird inspection procedure can be attained by sampling, without loss of consumer protection, then we will consider submitting a legislative proposal to amend the law so as to authorize the new method.

DISCRETIONARY INSPECTION

Question: You indicate that you have additional enforcement authority under the new legislation. Under two of your noted instances you list the temporary withdrawal of inspection as an enforcement measure. What does this mean? For example, if a plant is under discretionary inspection with, perhaps, only one inspection a week, if you temporarily withdraw inspection, does that mean the plant has to stop immediately or does it only have to stop at its next scheduled inspection?

Answer: The new temporary withdrawal measures give USDA authority to seek the temporary removal of an individual responsibly connected with the plant, pending an administrative hearing, when the individual has been convicted of a multiple misdemeanor or felony violation of the inspection acts. USDA also has new authority to ask for a court order temporarily withdrawing inspection or removing a responsible individual in the case of repeated violations of the acts, or if there is a direct and substantial threat to public health or safety. Finally, USDA may temporarily withdraw inspection in a plant where threats or assaults against inspectors occur.

A plant under discretionary inspection where an inspector visits once a week is unlikely to have inspection suddenly withdrawn, even temporarily, unless there is a direct and substantial threat to public health or safety. USDA would ordinarily choose from a variety of measures short of withdrawal in an attempt to bring the plant into compliance with the laws. We might increase the frequency of inspection, perhaps to continuous inspector presence in the plant. We might send it warning letters. We might place the plant under the Intensified Regulatory Enforcement program. Failing these, we might, as the amendments provide, notify the plant that we are considering bringing a criminal action and give it time to reform its procedures. Finally we might ask the Department of Justice to prosecute the case in the courts. Most instances of withdrawal under the new provisions would take effect under a court order following a conviction.

Withdrawal of inspection would be in effect as the withdrawal order states, for the whole period that the plant might operate, regardless of any past or current schedule of inspection visits.

Question: Is it true that Discretionary Inspection only applies to red meat?

Answer: The 1986 amendments allowing discretionary inspection were amendments only to the Federal Meat Inspection Act, not to the Poultry Products Inspection Act. The poultry act does not contain the phrasing which, in the meat act, required daily visits from inspectors. With passage of the amendment we are proceeding to implement discretionary inspection in both meat and poultry processing plants.

BUDGET REQUEST

Question: Your budget includes an increase of $2,833,000 to offset the rising cost of non-salary items and the added workday in 1988. Please explain.

Answer: The budget request includes a 3.9 percent increase for inflation related increases in costs of goods and services provided by the private sector for the Food Safety and Inspection Service. This is for increasing costs in travel, supplies, equipment, and communications. Also in fiscal year 1988 there are 262 federal workdays, compared to 261 in fiscal year 1987, for which we have to pay our employees. The number of workdays varies from year to year and can be a significant cost factor as our personnel salaries and benefits run about a million dollars a day.

Question: Your budget contains a decrease of $2 million because of the first year's effects of the discretionary inspection legislation which was passed. Specifically, to what is this $2 million decrease attributed?

Answer: The Budget estimate assumes that upon implementation of discretionary inspection we will retard the hiring of new processing inspectors and permit attrition to begin reducing the number on the payroll.

Question: Does this mean fewer inspections made or inspectors used?

Answer: We expect that this new procedure will allow a significant reduction in the number of processing inspectors--approximately 50 percent of the present number--when the program is fully implemented in several years.

Question: Given that you are implementing some pilot projects now, do you expect reduced costs for fiscal year 1987?

Answer: No. The initial costs of setting up the program will offset any saving from staff reductions in fiscal year 1987.

Question: Will you expect additional reductions in following years or do you expect to have your discretionary inspection fully implemented by the beginning of fiscal year 1988?

Answer: We expect to begin implementing the new discretionary inspection procedures in 1988. However, we have assured the congress and our employees that we will not have a reduction in force as a means of accomplishing staffing reductions. Rather, we will rely on attrition to reduce the number of processing inspectors. This will take a number of years.

Question: If you expect additional reductions as you implement the new legislation, what are they and when will they be achieved?

Answer: We expect the saving to average an additional four and a half million dollars each year for the next four years. The exact amount will depend on the attrition rate.

Question: Your explanatory notes indicate that your staff level remains exactly the same for 1986, 1987, and 1988. How many actual inspectors do you have for each of those years?

Answer: The number of inspectors in FSIS declined to a low point of 7,070 in July 1986. At that time we received a supplemental appropriation that permitted the agency to resume hiring so that by the end of the fiscal year the number of inspectors reached 7,440. For 1987 we expect an end of year employment level of approximately 7,340 inspectors and 7,400 at the end of 1988.

Question: What are their grades?

Answer: The entry level of a meat and poultry inspector is a GS-5. With the exception of a few inspectors assigned to complex processing operations, all other inspectors are classified as GS-7 through GS-11 depending on whether the plant is slaughter or processing, the difficulty of work, and the supervision provided. All inplant veterinarians are classified at the GS-11, 12 or 13 level depending on supervisory responsibility.

Question: Has the number of inspectors changed since 1985?

Answer: Yes, since 1985 our employment shows a decrease of about 140 inspectors, achieved primarily by streamlining agency operations.

Question: After you take into account the increased costs associated with the 1986 pay raise as well as the additional costs associated with the Federal Employees' Retirement System, you are still requesting an additional $4.5 million to provide an adequate staffing level. Are you anticipating a staffing shortfall for fiscal year 1987? If so, will you request a supplemental appropriation? If not, why do you need the $4.5 million increase for fiscal year 1988?

Answer: We do not expect a staffing shortfall in fiscal year 1987, though we will require a supplemental appropriation in 1987 to fund the pay increase which took effect in January 1987 and the new Federal Employees' Retirement System.

We will require $4.5 million in 1988 to fund the agency at its full staffing level. Our staffing fell sharply during the first eight or nine months of fiscal 1986, until a supplemental appropriation provided the resources to begin hiring inspectors to make up these losses. In fiscal 1988, we expect a net increase of about 60 new inspectors to bring our staff up to the level necessary to cover all assignments.

Question: According to your explanatory notes, the appropriation will support the same amount of staff years. Again, why is the $4.5 million over and above increases for the pay raise and the federal employment retirement system needed when the staff years remain level?

Answer: There are several factors influencing the staff year figures. The 1987 staff year ceiling which is reflected in the Budget, is about 72 higher than we can finance with the funds available in that year. The revised 1987 total would be 9[illegible]0. In 1988 we are requesting increases of 153 staff years for restoration of staffing, program reviews, and the return of one position transferred to FAS in 1987. Offset against this is a reduction of 80 staff years generated by savings associated with the implementation of discretionary inspection. The following table shows this more clearly:

1987 Staff Year ceiling	9542
Revised 1987 estimate	9470
Restoration of staffing levels	+140
Restoration of FAS position	+1
Program reviews	+12
Discretionary Inspection	-80
1988 Budgeted Staff Years	9543

Question: You indicate in your testimony that the addition is needed to replace the cuts necessitated by enactment of the Gramm-Rudman-Hollings law. However, the staff level for fiscal years 1987 and 1988 is already almost 250 staff years higher than fiscal year 1986. Are there additional reasons for this increase?

Answer: In 1985, the last year before Gramm-Rudman-Hollings, FSIS employed 9719 staff years in carrying out its mission. In 1986 that number declined to 9292. In 1988, even after taking into consideration the 80 staff year saving from the discretionary inspection legislation, our 1988 level is still almost 100 below the 1985 pre-Gramm-Rudman-Hollings level.

1985 Actual Staff Years	9719
1986 Actual Staff Years	9292
1987 Estimated Staff Years	9470
1988 Estimated Staff Years	9543

IMPORT MEAT AND POULTRY INSPECTION

Question: I understand that FSIS is working on its program for inspecting imported meat and poultry in order to ensure that products are imported only from countries and plants meeting U.S. requirements. In this regard, you are developing a new systems approach for approving and monitoring foreign inspection systems. One of the issues involved is the defects in canned packaged meat products. What is the status of your work in this area?

Answer: An agency task force has completed its re-examination of defect criteria used to evaluate the condition of containers for shelf-stable product. A field test of these criteria is under way. A procedural directive should be issued August 1, 1987. We will be notifying foreign countries of our new criteria as soon as a draft of that directive is available. It will be the responsibility of each eligible foreign country to implement equivalent procedures. Port of entry reinspection procedures will be changed at the same time as the domestic program implements its procedures.

Question: When do you expect to complete your review of this matter and the implementation of changes to improve it?

Answer: Implementation of the new shelf-stable container defect inspection procedures is planned for August 1, 1987.

Question: Have you set up a better review system for compiling information on the effectiveness of foreign inspection systems and ensuring compliance with U.S. requirements? If so, what is the system?

Answer: We have been working on implementation of the systems approach to country eligibility for some years. The 1979 task force charged with designing a system for risk based assessment proposed seven risk areas. After a considerable amount of design, field testing, and analysis, we now believe that five risk areas satisfactorily define an inspection program. We have defined various control programs covering single aspects of each risk area. Evaluation of these control programs forms the basis on which eligibility is determined. Information used in the evaluation comes from reviews of laws, regulations, responses to questionnaires, on-site reviews of the inspection service in operation, and other data such as residue testing plans and results. The evaluation process is continually being updated through information obtained from routine on-site reviews, country responses to information requests, reports submitted to FSIS as a result of problems, and reinspection sampling at import stations.

QUESTION SUBMITTED BY SENATOR CHILES

PIZZA REGULATION

Question: For some time now, consumer groups and the dairy industry have sought for clear, distinct labeling of meat-cheese pizzas using imitation cheese. Seventy five percent of frozen meat-cheese pizzas contain imitation cheese, yet consumer studies show that the consumer thinks they are buying pizza with real cheese. Consumers have the right to know what they are buying isn't the real thing. I know the Department has considered issuing regulations to require clear and distinct labeling on the front panel of frozen pizza packages. Why has it taken you so long to issue the regulation? When will the Department final issue the proposal?

Answer: The Department received a total of 5543 written comments on the proposal; ninety-five percent addressed the issue of the cheese content of pizzas, or the labeling of meat and poultry products containing cheese substitutes. Most of these comments--a total of 5,155--were submitted by consumers. Comments received represented mixed viewpoints.

The issue has been given very careful and extensive consideration by the Department. Arguments and evidence for and against the proposal have been identified and weighed. It is the conclusion of the Department that the comments in opposition to the proposed rule are persuasive and that the new requirements are not necessary. Therefore the Department has decided to withdraw the proposal and terminate rulemaking proceedings in this matter.

QUESTIONS SUBMITTED BY SENATOR BUMPERS

USER FEES

Question: Dr. Houston, health and safety related inspection programs conducted by OSHA, EPA, and the FDA are examples of inspection programs which could be compared to the meat and poultry programs and which are funded without the use of user fees. Because, like those, meat and poultry inspection services are mandatory government services, wouldn't the imposition of user fees amount to a tax?

Answer: This proposal does not impose any new cost on the public. Rather it shifts the cost from general tax revenues to a user fee. While everyone in the country benefits from the program, they do not benefit equally. We expect the user fee program to equitably distribute the costs among the meat and poultry consuming public in relation to the benefits received.

Question: Because user fees would impose the cost of inspection on industry, isn't it a natural result that the cost would ultimately be passed along to the consumer?

Answer: In proposing this legislation it was our assumption that the cost of inspection would be passed on, flowing with the product through further processing in the direction of the consumer. However as the cost of inspection will be less than a penny a pound we do not believe that it will have any noticeable effect on consumer prices.

Question: The U.S. poultry industry has lost export markets, primarily as a result of subsidies offered by the European Community and Brazil. Higher costs to the industry resulting in higher prices would certainly make U.S. poultry products even less competitive in international trade. How would you propose to deal with that problem?

Answer: The cost of inspection is only a fraction of a cent per pound and it is unlikely to have any significant impact on sales domestically or foreign. As we view it, the export problem is one of trade barriers, not production costs, and we are continuing to work with the EEC to eliminate these barriers and insure a European market for our products.

HEPTACHLOR CONTAMINATION

Question: I read with interest your overview of your agency's actions in following the heptachlor contamination problem in Arkansas and surrounding states. Is any further testing being conducted at this time? What is your assessment of the current situation today?

Answer: At this time, testing in the area is continuing for the animals in herds identified as suspect last year. Some of the animals are adulterated with heptachlor residues; USDA will test live animals at the farmer's request to be sure that the animal is free of residues before marketing. Some animals may need as much as two years for the residues to clear their systems. No further problem with feed contamination has occurred since last year.

QUESTION SUBMITTED BY SENATOR KASTEN

CHEESE CONTENT OF PIZZA

Question: On March third, I wrote to Secretary Lyng requesting that the Department move quickly to approve or at least announce some decision on some regulations relating to the cheese content on frozen meat pizzas. These regulations were first issued in 1983; almost four years later, USDA has still not officially decided whether consumers should be informed that pizzas they expect to be made from real cheese are in fact made primarily with imitation cheese.

As I indicated in my letter to Secretary Lyng, I am astonished that it should take over four years to resolve a question that, while important to many people, is hardly of earth-shaking importance. It seems to me a fairly simple issue of public information, when polls show that consumers overwhelmingly believe that frozen pizzas are made with real cheese, to require that they be informed of the extent to which this is not the case.

I have nothing against imitation cheese. Much of it, in fact, is made in Wisconsin. The point of the regulations proposed in 1983, which I agree with, was that imitation cheese should make its case in the marketplace on its own merits, not by masquerading as something else. My question is this: is the Department ever going to announce a final disposition of the pizza labeling regulations? If so, when can we expect this to take place, and what do you expect that decision to be?

Answer: We are convinced that the proposed regulation is not warranted, and the proposal is being withdrawn.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

BIENNIAL BUDGET

Question: Calls for budget reform are increasingly heard as budget deadlines are too often missed, important budget decisions are delayed, appropriation bills and other direct spending legislation are held up in committee, and omnibus spending bills take the place of timely and orderly consideration of individual bills. One procedural reform that is being considered is the two-year budget cycle where budget and appropriations matters would be considered in the first year, and authorizations and oversight would be undertaken in the second year. Would your agency favor a biennial budget process?

Answer: FSIS sees a balance of advantages and disadvantages in a biennial budget cycle. We can, however, understand how it would greatly benefit many other agencies in the government: those with changing or evolving responsibilities where the changes are foreseeable.

Question: What benefits would your agency achieve in a two-year appropriation cycle?

Answer: The longer budget cycle would improve the planning and implementation of relatively permanent changes to the inspection system: program improvements, changes in inspection techniques, and services purchased from outside the agency, such as studies, contracts for testing methods, use of contract laboratories, or new information systems. These items, however, are only a small part of our budget.

Question: Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer: Most of the budget request is an adjustment of that of the previous year, simply because the Agency's work is the enforcement of a mandatory public health program and that charge does not change from one year to another.

Question: What difficulties can you foresee in preparing and submitting a two-year budget to Congress?

Answer: This Agency must commit well over ninety percent of its funds for the maintenance of its inspection staff, their necessary travel and training, and the support of State inspection programs. Events such as pay raises, federal personnel regulations affecting travel and benefits, USDA assumption of State inspection programs, or the outbreak of a widespread contamination incident would mean supplemental appropriation requests at a frequency negating the benefits of a biennial budget.

Question: If you oppose the biennial budget concept, please give this subcommittee your reasons why.

Answer: Our Agency's spending categories are relatively simple: by far the great bulk of our budget goes to salaries and benefits for employees. In our case, however, the simplicity is tied to the rigidity and immediacy of our funding needs. The inspectors must be available, both to ensure enforcement of the law and to allow daily operation of the regulated industry. The agency enjoys little discretion to stretch out any of its programs or postpone their implementation. For all practical purposes, any decision requiring a substantial cut in the agency's funding can be carried out only through the suspension of hiring to replace inspectors, and that can scarcely take effect quickly or without an interruption of service.

More specifically, this agency would experience little difference in the frequency of budget submissions, since a second-year supplemental appropriation to the budget would normally be necessary. These include federal pay increases, legislative and regulatory changes affecting the cost of federal employment (such as increased health insurance costs), and possible changes in the level of USDA assistance needed to maintain fifty percent assistance to State inspection programs. The execution of the two year-budget would in fact add some problems since the uncertainties of available funding for second-year staff costs and State program needs would make it difficult to plan the agency's twenty-four month hiring strategy and State grant allocation for the entire cycle.

In short, the budget requests of FSIS are characterized by a proportionately large, constant fixed cost in the form of a mandatory program entailing staff and Grants costs, with almost no surplus to reallocate to new funding needs. As a result, we must come to Congress often for the needed funding, and we believe we would continue to do so even under a biennial budget.

SUBCOMMITTEE RECESS

Senator BURDICK. This concludes today's hearing. We appreciate your being here today to share with us concern over the fiscal year 1988 appropriations for the Department of Agriculture.

Our next hearing will be held next Monday, March 23, beginning at 2 p.m., in room SD–138. At that time, we will hear from representatives from the Agricultural Stabilization and Conservation Service, the Commodity Credit Corporation, and the Federal Crop Insurance Corporation. Until then, the subcommittee stands in recess.

[Whereupon, at 11:35 a.m., Thursday, March 19, the subcommittee was recessed, to reconvene at 2 p.m., Monday, March 23.]

AGRICULTURE, RURAL DEVELOPMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 1988

MONDAY, MARCH 23, 1987

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–138, Hon. Quentin N. Burdick (chairman) presiding.

Present: Senators Burdick, Bumpers, Sasser, Cochran, McClure, Kasten, and Grassley.

DEPARTMENT OF AGRICULTURE

AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE

STATEMENTS OF:

- DANIEL G. AMSTUTZ, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS AND COMMODITY PROGRAMS, DEPARTMENT OF AGRICULTURE
- MILTON J. HERTZ, ADMINISTRATOR, AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE, AND EXECUTIVE VICE PRESIDENT, COMMODITY CREDIT CORPORATION

ACCOMPANIED BY:

- DAVID C. HALL, DIRECTOR, BUDGET DIVISION, AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE
- ROBERT E. SHERMAN, DEPUTY BUDGET OFFICER, DEPARTMENT OF AGRICULTURE

OPENING REMARKS

Senator BURDICK. The subcommittee will please come to order.

Today we continue with our hearings reviewing the proposed fiscal year 1988 budget for the Department of Agriculture. Specifically, we will concentrate on the Agricultural Stabilization and Conservation Service, the Commodity Credit Corporation, and the Federal Crop Insurance Corporation. This will be the second appearance for the Agricultural Stabilization and Conservation Service because it appeared earlier on the conservation programs under its jurisdiction.

With us today, representing these agencies, we have Mr. Daniel G. Amstutz, the Under Secretary for International Affairs and Commodity Programs; Mrs. Kathleen Lawrence, the Under Secretary Designee for

Small Community and Rural Development; Mr. Milton J. Hertz—a noted and famous fellow from North Dakota—the Administrator of the Agricultural Stabilization and Conservation Service, as well as the Executive Vice President of the Commodity Credit Corporation; Mr. E. Ray Fosse, the Manager of the Federal Crop Insurance Corporation; and Mr. Robert Sherman from the USDA Budget Office.

Welcome to you all.

COMMODITY CREDIT CORPORATION

For the Commodity Credit Corporation, the budget for fiscal year 1988 requests a permanent, indefinite appropriation. In other words, any funding that the corporation needs to pay its realized losses would be made automatically from the U.S. Treasury. The administration also requests an increase in the borrowing authority for the Commodity Credit Corporation from the current $25 billion to a $40 billion level. This increase was recommended by this committee last year.

In addition, the Commodity Credit Corporation is in need of a supplemental appropriation for fiscal year 1987 in the amount of $6.7 billion. Because of the $25 billion borrowing authority limit, the Commodity Credit Corporation in recent years has needed several supplemental appropriations throughout the year because so much of the $25 billion is constantly in use by the corporation.

AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE

The Agricultural Stabilization and Conservation Service is also requesting a supplemental appropriation of $24 million for its salaries and expenses. This is due to the extremely high workload as a result of the farm program. The local county offices are experiencing major workload increases due to the commodity certificate program, increased loan activity, and an increase in farm program participation.

For fiscal year 1988, the administration is requesting $527,663,000 for ASCS salaries and expenses which will be an $11.8 million increase over the fiscal year 1987 level, assuming the $24 million supplemental is provided.

FEDERAL CROP INSURANCE CORPORATION

For the Federal Crop Insurance Corporation budget, the administration requests $215.2 million for its administrative and operating expenses. This is approximately $5.6 million more than fiscal year 1987. For the Federal Crop Insurance Corporation fund, the fiscal year 1988 proposed level is $284.8 million, or approximately $149 million above the fiscal year 1987 level.

In addition, the administration will propose legislation to phase out government program costs over the next 5 years for both premium subsidy, and administrative and operating expense.

With that brief introduction, I would like to remind you that your statements will be made part of the record in full, and I ask that you summarize them to the extent you feel necessary and appropriate. You may proceed in the order that you wish.

STATEMENT OF DANIEL AMSTUTZ

Mr. AMSTUTZ. Thank you, Mr. Chairman.

I am pleased to have this opportunity to appear before you and the committee to discuss the fiscal year 1988 budget and program proposals for the Agricultural Stabilization and Conservation Service and the Commodity Credit Corporation.

I am accompanied this afternoon by Mr. Milton Hertz, the Administrator of ASCS; David Hall, Director of the Budget Division of ASCS; and Mr. Robert Sherman, Deputy Budget Officer of the Department of Agriculture.

Mr. Chairman, Mr. Hertz will give a more detailed statement, but, with your indulgence, I would like to make just a few introductory remarks.

Mr. Chairman, as the committee is aware, the administration is committed to meeting the Gramm-Rudman-Hollings deficit target of $108 billion in fiscal year 1988. Reducing the size of the federal deficit will greatly benefit the American economy and American agriculture in particular.

We have, therefore, developed our fiscal year 1988 budget proposals cognizant of the legitimate needs of American farmers, but also of the benefits to be gained from lowering the federal deficit. Tough choices had to be made in preparing this budget, Mr. Chairman. Not all of the programs we would like to fund, or others would like us to fund, could be accommodated in our fiscal year 1988 proposal.

Our present estimate for CCC price support program outlays in fiscal year 1987 stands at $25.3 billion, near the record of $25.8 billion reached last year. For fiscal year 1988, CCC outlays are projected to be lower, but still above $20 billion. These outlays substantially exceed the estimates that were prepared when the Food Security Act was enacted 14 months ago.

In view of these escalating costs, the administration is proposing legislation that should lower farm program costs by over $20 billion over a 5-year period.

We are also proposing legislation to increase the limitation on CCC borrowing authority from $25 billion to $40 billion, and to provide CCC with permanent, indefinite appropriation authority. Enactment of these two proposals is essential to ensure that CCC has the resources it needs to carry out its program responsibilities under the Food Security Act.

Moreover, these actions will help avoid the disruptions in CCC operations which have occurred all too frequently during the past several years. Again this year, CCC is facing a depletion of borrowing authority by late April or early May, and supplemental funding will be needed for the corporation to meet its program obligations for the remainder of fiscal year 1987.

I urge the committee and the Congress to give prompt consideration to these proposals to avoid another suspension of CCC payments and the hardship for farmers and others which would result from it.

Another problem we have, Mr. Chairman, is to ensure that we have adequate administrative support to carry out the programs provided by the Food Security Act. In this regard, we are submitting a supplemental appropriation request of $24 million for ASCS salaries and expenses in fiscal year 1987. This additional funding is critically needed to ensure that adequate staffing is available in the county offices to provide efficient and timely service to program participants.

That concludes my introductory remarks, Mr. Chairman. If you like, we could go right to Mr. Hertz for his presentation.

STATEMENT OF MILTON HERTZ

Mr. HERTZ. Mr. Chairman, I, too, would like to thank you for the opportunity to discuss the fiscal year 1988 budget request for the Commodity Credit Corporation and for the ASCS salaries and expenses account. I would like to address the CCC portion first.

CCC REQUEST

High 1985 crop production and weakened demand produced record fiscal year 1986 CCC net outlays, approximately $25.8 billion compared to the previous high of $18.8 billion in fiscal year 1983.

Commodity loan making, loan forfeitures, and year end inventories of commodities held by CCC of $11 billion were all historical highs. Our total loan making was approximately $17.4 billion, and approximately $5.5 billion in loans were forfeited. As we ended the year, we had approximately $11 billion of the inventory in the CCC.

For fiscal year 1987, the first full year for which the Food Security Act will be in effect, CCC net outlays are estimated at a near-record $25.3 billion, mostly for 1986-crop programs.

For fiscal year 1988, CCC net outlays are projected to decrease to $21.3 billion due mainly to a lower net loan activity for corn as a result of a larger production adjustment program for the 1987 crop.

Also contributing to the outlay decrease is the shift of conservation reserve program funding from CCC to a separate appropriation and the assumption that there will be no 1988 crop advance deficiency payments.

In view of the continued high levels of CCC outlays, our budget includes proposals to address both the near-term cash flow needs of the corporation and the longer term problem of an orderly process for reimbursing CCC realized losses.

Since October, when appropriations of $19.8 billion were authorized to reimburse CCC for net realized losses, CCC outlay estimates for fiscal year 1987 have increased to $25.3 billion. Therefore, we are requesting a supplemental of $6.7 billion through permanent, indefinite appropriation authority. It is estimated that without the additional funds, CCC will exhaust available borrowing authority by late April or early May.

For fiscal year 1988, we are also requesting a permanent, indefinite appropriation estimated at $21.1 billion.

As a long-term measure, we are requesting legislation to increase the CCC borrowing authority limitation from $25 billion to $40 billion. Because virtually all of the current authority is encumbered by commodity loans, and inventory investment, frequent urgent supplementals have been required in recent years to meet cash needs.

We believe that the increase in borrowing authority, coupled with permanent, indefinite authority to restore losses, is essential for the orderly financing of the requirements of the farm price support legislation.

We appreciate very much this committee's responsiveness in the past in providing us with the capital needs of the corporation.

ADMINISTRATIVE EXPENSES

As we look toward the administrative part of the agency, continuing heavy workload associated with the provisions of the Food Security Act and the current economic conditions in the farm sector is putting severe pressures on our county office administrative operations in fiscal year 1987. Producer participation in the major commodity programs for the 1986 crop-year is up from last year's level, ranging from 85 to 91 percent of commodity bases enrolled.

Except for the signup activity, this workload for the 1986 crop-year falls mostly on this current year. We are experiencing major workload increases over last year in commodity loanmaking and servicing volumes, loan forfeiture volumes, and CCC commodity certificates issuance and redemption activities.

We are requesting an urgent supplemental of $24 million for ASCS salaries and expenses to finance these workload increases, as well as unbudgeted administrative needs for advance payments and 1986-crop disaster payment activities. This request is for 1,485 critically needed county office staff-years, largely for temporary employees, for a total of almost 16,000 staff-years. Current funding would finance only 14,300 county staff-years, well below last year's actual level of nearly 15,000.

I would like to note, Mr. Chairman, that this request for $24 million includes no restoration of last year's Gramm-Rudman-Hollings reduction of $17 million for this account, and is the minimum we need to timely service farmers and stay reasonably current with our workload.

In addition, the budget includes funding requests for the 1987 pay raise and the new Federal Employees Retirement System of $9 million and $9.9 million respectively. Our total adjusted fiscal year 1987 request for CCC transfer authority is $534.7 million.

For fiscal year 1988, we do anticipate some workload reduction in our request of $527.7 million. The reduction is due primarily to reduced loanmaking, lower deficiency payment activity, the expiration of the 1986-crop disaster payment program, lower conservation cost-share activities, and benefits accruing from full county automation implementation by early 1988.

The workload reductions total 2,160 county and 115 federal staff-years and $25 million, and would reduce total county office staff-years to 13,669 for fiscal year 1988. However, these projected staffing decreases are largely offset, in dollar terms, by increases over fiscal year 1987 for pay cost annualization of $3 million and additional retirement costs of $15 million.

PREPARED STATEMENT

Mr. Chairman, this concludes my statement, and I will be happy to respond to any questions.

Senator BURDICK. Thank you.

[The statement follows:]

STATEMENT OF MILTON HERTZ

Mr. Chairman and Members of the Subcommittee, I want to thank you for this opportunity to discuss the fiscal year 1988 budget request for the Commodity Credit Corporation and the Agricultural Stabilization and Conservation Service Salaries and Expenses Account.

Commodity Credit Corporation
Commodity Program Outlays

High 1985 crop production, particularly for corn, wheat, cotton and soybeans, and weakened demand for these commodities, combined to produce record CCC net outlays in fiscal year 1986. Compared to the previous high of $18.9 billion for fiscal year 1983, net outlays in fiscal year 1986 were $25.8 billion. Total commodity loan making of $17.4 billion, loans forfeited to CCC of $5.5 billion, and year-end inventories of commodities held by CCC of $11.0 billion were all historical highs.

For fiscal year 1987, the first full year for which provisions of the Food Security Act will be in effect, CCC net outlays are estimated at a near-record $25.3 billion. This spending is mostly for 1986-crop programs, and although price support levels are lower and target prices frozen, pressures on market prices and very high producer participation in the major commodity programs are acting to keep CCC spending comparable to last year's level. Commodity loan making, loan forfeitures to CCC, and year-end inventories are all projected to remain at, or exceed, the fiscal year 1986 highs. Included in the 1987 estimates is the direct CCC financing of $700 million in Conservation Reserve Program outlays.

CCC net outlays are projected to decrease to $21.3 billion in fiscal year 1988, mostly due to lower net loan activity for corn because of a larger production adjustment program for the 1987 crop as well as the fact that 1988 crop advance deficiency payments are not assumed in the President's

Budget. Contributing to the decrease in CCC-financed outlays in fiscal year 1988 is the legislatively required change in the financing of the Conservation Reserve Program, from CCC to a separate advance appropriation.

CCC Financing

Our Budget request includes a number of proposals for financing the continued high levels of CCC outlays. These proposals address both the near-term cash flow needs of the Corporation and the longer-term problem of a more orderly process for appropriating reimbursement of operating losses incurred by CCC.

Fiscal year 1987 appropriations enacted to date for reimbursement of CCC losses total $19.8 billion. Since the time these funds were authorized in October of last year, CCC outlay estimates have increased to the $25.2 billion level shown in the President's Budget. So, we have an urgent need of $6.7 billion in additional capital to finance CCC's operating needs for the remainder of fiscal year 1987. Without the requested funds, it is estimated that CCC will exhaust its available borrowing authority by late April or May.

The fiscal year 1987 CCC supplemental request included in the President's Budget is in the form of a request for permanent, indefinite appropriation authority. Upon enactment, this authority would be used to recover from Treasury $6.7 billion in CCC losses. For fiscal year 1988, we are also requesting a permanent, indefinite appropriation, estimated at $21.1 billion, which would fund CCC's cash needs for that year.

We are also requesting, as a longer-term measure for dealing with CCC financing requirements, legislation to increase the current CCC borrowing authority limitation from the present $25 billion to $40 billion. The

$25 billion cap on outstanding borrowings has not been increased since 1982, and virtually the entire borrowing authority is now encumbered by commodity loan and inventory investment. In order to remain within the present $25 billion ceiling, frequent urgent supplementals have been required in recent years to meet cash needs. We believe both measures proposed in the Budget, the permanent, indefinite appropriation authority for restoring losses, and the increase in borrowing authority, are essential to a more orderly approach for annually financing the requirements of farm price support legislation.

We very much appreciate this Committee's responsiveness in the past in providing for the capital needs of the Corporation. We are also encouraged by the recommendation of the Conferees in the 1987 Omnibus Continuing Resolution report regarding an increase in the present borrowing authority ceiling.

Farm Program Legislation

Mr. Chairman, legislation to reform farm programs administered through the CCC was recently submitted to the Congress. The major outlay impacts of these proposals would be after fiscal year 1988, and would save over $20 billion over a five-year period. Included in the proposals are reductions in target prices from the 1987 levels, decoupling of deficiency payments and production, and proposals regarding the sugar program.

Administrative Support

Continuing heavy workload associated with the provisions of the Food Security Act and current economic conditions in the farm sector are putting severe pressures on our county office administrative operations in fiscal year 1987. Producer participation in the major commodity programs for the 1986 crop year is up from last year's levels, ranging from 85 to 91 percent of commodity bases enrolled. Except for signup activity, this workload for the 1986 crop programs falls mostly in the current year. Currently, we are experiencing major workload increases over last year in commodity loan making and servicing volumes, loan forfeiture volumes, and in CCC commodity certificate issuance and redemption activities.

We are requesting an urgent supplemental of $24 million for ASCS Salaries and Expenses to finance these workload increases, as well as for unbudgeted administrative needs for advance payments and 1986-crop disaster payment activities. This request is for 1,485 critically needed county office staff years, largely for temporary employees, and would allow us to fund a total of 15,829 staff years. Current funding authorized for fiscal year 1987 would finance only 14,344 county staff years, well below last year's actual level of 14,874. I would like to note, Mr. Chairman, that this request of $24 million includes no restoration of last year's Gramm-Rudman-Hollings reduction of $17 million for this account. We will have to use improved efficiency to permanently offset this reduction; therefore this is the minimum amount we need to timely service farmers and stay reasonably current with our workload.

In addition to the county workload supplemental, the Budget includes funding requests for the 1987 pay raise and the new Federal Employees Retirement System of $9.0 million and $9.9 million, respectively. Our total adjusted FY 1987 request for CCC transfers is $534.7 million.

For fiscal year 1988, we do anticipate some workload reduction in our request of $527.7 million. The projected reduction is due primarily to lower estimated loan making because of a larger acreage reduction program for corn, lower deficiency payment activity based on no advance payments assumed for the 1988 crops, the expiration of the 1986-crop disaster payment program, lower conservation cost-share activities, and benefits accruing from full county automation implementation by early 1988. These workload reductions total 2,160 county and 115 Federal staff years and $25 million, and would reduce total county office staff years to 13,669 for FY 1988. However, these projected staffing decreases are largely offset, in dollars terms, by increases over fiscal year 1987 for pay cost annualization of $3 million and additional retirement costs of $15 million.

This concludes my prepared remarks. I will be happy to respond to any questions.

FEDERAL CROP INSURANCE CORPORATION

STATEMENTS OF:

KATHLEEN LAWRENCE, UNDER SECRETARY DESIGNEE, SMALL COMMUNITY AND RURAL DEVELOPMENT

E. RAY FOSSE, MANAGER, FEDERAL CROP INSURANCE CORPORATION

ACCOMPANIED BY:

EDWARD D. HEWS, DEPUTY MANAGER, FEDERAL CROP INSURANCE CORPORATION

ROBERT E. SHERMAN, DEPUTY BUDGET OFFICER, DEPARTMENT OF AGRICULTURE

PURPOSE OF THE CORPORATION

Ms. LAWRENCE. Good afternoon, Mr. Chairman.

It is my pleasure to appear before this committee on behalf of the Federal Crop Insurance Corporation.

The Federal Crop Insurance Corporation, as you know, is a wholly owned government corporation that has been providing farmers with all-risk insurance since 1938. The stated purpose of the corporation is to promote the national welfare by improving the economic stability of agriculture through a sound system of crop insurance. Our program legislation was amended in 1980 to provide for nationwide expansion of a comprehensive crop insurance program as the alternative to various emergency disaster relief schemes.

The present Federal Crop Insurance Corporation program provides a cost-sharing insurance program for agricultural producers so as to reduce losses resulting from decreased crop production that is caused by unavoidable events of nature.

The crop insurance program constitutes a joint effort by the private sector and the government in the delivery of the program. Currently, risk-bearing companies reinsured by FCIC account for about 80 percent of sales. These companies provide the insurance marketing, servicing, training, quality control, and loss adjustment functions and share, to a limited extent, in both profits and losses. The other 20 percent of sales is conducted through private agents affiliated with Master Marketers under contract with FCIC.

In addition to these two delivery systems, in areas where an adequate private sector facility is not available, FCIC may ask other USDA agencies to sell and service all-risk crop insurance through existing county offices.

Legislation will be submitted pursuant to the 1988 budget to provide for a phaseout, over the next 5 years, of government premium subsidy costs and the federal payment of administrative and operating expenses. Farmer-paid premiums would be increased correspondingly. The objective, under this proposal, is to transfer to the private sector by 1992 all functions, except an ultimate premium sustained reinsurance program.

Bills reflecting the same initiative in the 1987 budget were introduced in both Houses of the 99th Congress. No action was taken. The corporation is once again submitting budgets which would be operative under both the existing and the proposed legislation.

This concludes my statement, and with your permission, I would like now to turn to Mr. Fosse, the Manager of the Federal Crop Insurance Corporation, to provide the details of the corporation's fiscal year 1988 budget.

Thank you.

STATEMENT OF MR. FOSSE

Mr. FOSSE. Mr. Chairman, and members of the subcommmittee, it is my pleasure to appear before the subcommittee to present the 1988 budget for the Federal Crop Insurance Corporation.

We have submitted a prepared statement which, with your permission, we would like to have entered into the record, but I will summarize the highlights.

The Federal Crop Insurance Corporation is submitting for fiscal year 1988 budget proposals under existing legislation and under proposed legislation.

BUDGET REQUEST

The fiscal year 1988 budget request under existing legislation calls for administrative and operating expenses of $215.2 million. About $162.9 million, or 76 percent, will be required for reinsurance agreements with private commercial insurance companies and for commissions paid under the agency sales and service agreements and loss adjustment costs related to the direct writing of crop insurance. Also included is the amount to be reimbursed to ASCS.

The remaining $52.3 million will be used for the expenses of the Federal Crop Insurance Corporation, to maintain field operations offices, the Kansas City operations office which includes computer support, office automation and management information costs, and the headquarters staff.

The $215.2 million is $5.6 million greater than the fiscal year 1987 appropriation of $209.6 million, or about 2.7 percent.

Premium costs are estimated to increase to about $513 million compared to $500 million, or about a 2.6-percent increase. Insured acres are also estimated to increase to 60 million from an estimated 58.6 million in 1987.

FCIC FUND

For the FCIC Fund, premium subsidy appropriation for fiscal year 1988 is $228.5 million. Of this amount, $129.2 million is for the 1987 crop-year at 100 percent, compared to $124 million for fiscal year 1987 covering crop-year 1986, an increase of $5.2 million. The remaining

$99.3 million is for the 1988 crop-year at 75 percent, and also represents an increase over fiscal year 1987, for a total increase of $104.5 million.

The fiscal year 1987 appropriation only covered premium subsidy for the 1986 crop-year at 100 percent. Beginning in fiscal year 1988, the corporation will institute a major change in its accounting and budgeting systems for the FCIC revolving fund.

As directed by GAO, and to bring its financial statements into conformance with generally accepted accounting principles, including Financial Accounting Standards Board Statement No. 60, the corporation will match revenues and expenses in its financial statement, and will include these amounts in the fiscal year in which they are earned or incurred. The corporation historically deferred all income and losses of the current crop-year for inclusion in the following fiscal year.

Fiscal year 1988 is a catchup year for premium subsidy appropriation in order to comply with these accounting changes. Subsequent fiscal year requests for premium subsidies will include approximately 25 percent of the preceding crop-year and 75 percent of the current crop-year requirements. This breakout recognizes that fiscal year and crop-year do not match.

INTEREST REIMBURSEMENT

Interest reimbursement for fiscal year 1988 is $56.3 million. This amount is to reimburse the FCIC Fund for interest paid on Treasury borrowing, and CCC borrowing incurred during prior years, but not previously reimbursed. The amount represents a $44.6 million increase over fiscal year 1987.

The total budget for fiscal year 1988 is $500 million for ongoing programs, which is $154.7 million more than the total 1987 appropriation. Of this increase, $104.5 million is for premium subsidy change, $5.2 million program increase, and $99.3 million for the accounting change, $44.6 million for the interest increase, and $5.6 million is for administrative and operating expenses associated with the $12.1 million increase in projected sales.

The fiscal year 1988 budget request also includes budgets for the proposed legislation. Under this proposed budget, the crop-year 1988 program levels of $513 million in premium and 60 million insured acres are the same as for those under the existing legislation. The method of funding the crop insurance program, however, is not the same.

Legislation will be proposed to increase the producer's share of premium cost in order to phase out federal payment of administrative expenses and premium subsidy. The 1988 appropriation request reflects the first year of a 5-year phaseout of all federal operating subsidies. The objective is to transfer all crop insurance functions to the private sector by 1992, except that we will continue a premium-sustained catastrophic reinsurance facility.

ADMINISTRATIVE AND OPERATING EXPENSES

Administrative and operating expenses total $164.4 million by direct appropriation. The balance required of $41.1 million will be paid from premium income. The administrative and operating expenses will be phased out at 20 percent a year, beginning with fiscal year 1988, with no funds appropriated by fiscal year 1992.

A federal premium subsidy of $178.9 million will be required for 1988 under this proposal. This amount assumes the producer's share of the premium cost will be increased beginning in fiscal year 1988. Rather than the current rates of 70 percent for the producer and 30 percent appropriated subsidy, under proposed legislation the producer's share, beginning in crop-year 1988, would be 85 percent, and further increased to 90, 95, and 100 percent in crop-years 1989, 1990, and 1991, respectively.

Since it is proposed that all prior year borrowings be forgiven under proposed legislation, the reimbursement of prior years' interest cost of $56.3 million will not be requested.

UPDATE ON CROP-YEAR 1986

Briefly, an update on crop year 1986 experience.

Based on an earlier report, the President's budget submission for the crop year 1986 insurance operation reflects premiums for the reinsurance share at $320 million, and indemnities at $480 million, for a loss ratio of 1.5, with the remaining premiums of $80 million handled by Master Marketers. The direct federal paper indemnities are estimated at $139.2 million, which results in a loss ratio of 1.74.

However, current estimates show premiums for reinsurance operations at $305 million, with indemnities at over $460 million, for a loss ratio of 1.51, and $77 million in premium handled by sales and service contract, with direct indemnities currently estimated at $132 million, which results in a loss ratio of 1.71.

The combined efforts of the public and private sector show total premiums amounting to over $382 million, and total indemnities of about $592 million, for a combined loss ratio of 1.55.

PREPARED STATEMENT

This concludes my statement, Mr. Chairman. I will be happy to answer questions that you may have.

Senator BURDICK. Thank you very much.

[The statement follows:]

STATEMENT OF E. RAY FOSSE

It is my pleasure to appear before this Subcommittee to present the 1988 Budget for the Federal Crop Insurance Corporation.

The Federal Crop Insurance Corporation is submitting for fiscal year 1988 budget proposals under proposed legislation and under existing legislation.

Under proposed legislation, Federal costs for administrative expenses and for premium subsidy will be phased out over a five-year period beginning in 1988. Under existing legislation, Federal funding would continue to cover the administrative and premium subsidy expenses of the crop insurance program.

Under both proposals, program participation is estimated to increase from 46.9 million acres in 1986 to 58.6 million acres in 1987, and to 60.0 million acres in 1988.

First, I will discuss in detail the budget request under existing legislation.

Fiscal Year 1988 Budget Request

Our budget request for fiscal year 1988 under existing legislation is as follows:

-- $215,197,000 for Administrative and Operating Expenses to fund the expanded crop insurance program. About $147.6 million of this amount will be required for reinsurance agreements with private commercial insurance companies, and approximately $11.4 million for commissions paid under Agency Sales and Service Agreements and loss adjustment costs related to direct writing of crop insurance. Also included in the request is $3.9 million to be reimbursed to ASCS. These amounts total $162.9 million, and account for over 76 percent of the Corporation's total request for administrative expenses.

-- $228,523,000 for premium subsidy which includes $129,245,000 for the 1987 crop year (100%) and $99,278,000 for the 1988 crop year (75%). This request is an increase of $104.5 million over the F.Y. 1987 appropriation, and I have included a more detailed explanation of the need for this increase later in my statement.

The $228.5 million would provide for maximum expansion of the crop insurance program to an estimated $500 million premium in crop year 1987 and $513 million in crop year 1988.

-- Also included is a request for $56.3 million to reimburse the FCIC Fund for interest paid on Treasury borrowing and CCC borrowing incurred during prior years, but not previously reimbursed.

This represents a total budget request for fiscal year 1988 of $500,020,000 for on-going programs which is $154,709,000 more than the total 1987 appropriations.

Administrative and Operating Expenses

The appropriation request for Administrative and Operating Expenses for fiscal year 1988 will allow the Corporation to continue expansion of the crop insurance program. Resources are requested to expand insurance coverage from the crop year 1986 level of 46.9 million insured acres to 58.6 million insured acres in crop year 1987, and to 60 million insured acres in crop year 1988.

The major portion of the budget will be used to support private sector delivery systems. Two basic forms of delivery are currently in place: reinsured companies, which provide all of the fundamental insurance services and share underwriting gains and losses; and Agency Sales and Service Contractors who sell and partially service crop insurance written on FCIC paper, but are not at risk.

Of the amount requested for Administrative and Operating Expenses, about $159 million will be used for reinsurance administrative expense, loss adjustment costs, and contractor service fees. About $3.9 million is included as reimbursement to ASCS. The remaining $52.3 million will be used for the expenses of the Federal Crop Insurance Corporation to maintain field actuarial offices, field operations offices, Kansas City operations office which includes computer support, office automation and management information costs, and the Headquarters staff.

In total, our fiscal year 1988 request for Administrative and Operating Expenses represents an increase of $5.6 million over the fiscal year 1987 appropriations. About 80% of this amount is directly related to anticipated increases in program administration and compliance work.

Premium Subsidy

The fiscal year 1988 appropriation request of $228,523,000 for premium subsidies represents an increase of $104,489,000 from the fiscal year 1987 appropriation.

The $228,523,000 for premium subsidy will provide funding of $129,245,000 to cover the federal subsidy for producer premiums incurred in the 1987 crop year at 100 percent, and $99,278,000 for the 1988 crop year at 75 percent. The F.Y. 1987 appropriation only covered premium subsidy for the 1986 crop year at 100 percent. This amount represents 30 percent of the expected premium, up to the 65 percent level of coverage, as authorized by the Federal Crop Insurance Act, as amended in 1980.

Beginning in fiscal year 1988, the Corporation will institute a major change in its accounting and budgeting systems for the FCIC revolving fund. As directed by GAO, and to bring its financial statements into conformance with generally accepted accounting principles, including Financial Accounting Standards Board Statement No. 60, the Corporation will match revenues and expenses in its financial statements, and will include these amounts in the fiscal year in which they were earned or incurred. The Corporation historically deferred all income and losses of the current crop year for inclusion in the following fiscal year.

F.Y. 1988 is a "catch-up" year for premium subsidy appropriation in order to comply with FASB 60. Subsequent fiscal year requests for premium subsidy will include approximately 25 percent of the preceding crop year and 75 percent of the current crop year requirements.

Reimbursement for Prior Year Costs

The Federal Crop Insurance Act also provides for reimbursement to the Corporation for interest expenses incurred during prior years, but not previously reimbursed.

In fiscal years 1986 and 1987, the Corporation will use $56,300,000 from premium income to pay interest expenses and is requesting an appropriation for restoration in fiscal year 1988.

F.Y. 1988 Budget Request - Proposed Legislation

As I have indicated, the Corporation is also submitting a fiscal year 1988 budget request under proposed legislation.

Under this proposed budget, the crop year 1988 program levels of $512.4 million premium and 60 million insured acres are the same as those under existing legislation. The method of funding the crop insurance program, however, is not the same.

Legislation will be proposed to increase the producer's share of premium cost in order to phase out Federal payment of administrative expenses and premium subsidy. The 1988 appropriation request reflects the first year of a five-year phase-out of all Federal operating subsidies. The objective is to fully privatize the delivery of crop insurance by 1992.

Administrative and Operating Expenses total $164,394,000 by direct appropriation. The balance required of $41,098,000 will be paid from premium income. The Administrative and Operating Expenses will be phased out at 20 percent a year beginning with FY 1988, with no funds appropriated by FY 1992.

Federal premium subsidy of $178,883,000 will be required for 1988 under this proposal. This amount assumes the producer's share of the premium cost will be increased beginning in fiscal year 1988. Rather than the current rates of 70 percent for the producer and 30 percent appropriated subsidy, under proposed legislation, the producer's share beginning in crop year 1988 would be 85 percent, and further increased to 90, 95, and 100 percent in crop years 1989, 1990, and 1991 respectively.

Since it is proposed that all prior year borrowings be forgiven under proposed legislation, the reimbursement of prior years' interest costs of $56,300,000 will not be requested.

I would now like to review our accomplishments for the past year, and discuss our current plans and projections.

Crop Year 1986 Experience

Federal Crop Insurance is intended to become the primary form of Federal disaster protection for farmers, and eventually replace the current and emergency legislated farm disaster programs. Since enactment of the new legislation in 1980, insurance has expanded from 1,676 counties to over 3,000 counties. County programs have increased over 300 percent, from 4,629 in 1980 to 19,053 in 1986. Thus, crop insurance is now available in all agricultural counties on the acreage previously covered by disaster payments.

Acres insured, insurance in force, and premium have also increased substantially. In 1980, acres insured were 26.6 million compared with over 48 million for the 1986 crop year. Insurance liability in force has also increased for the same period, from $3 billion in 1980 to about $6.3 billion in 1986. Premium has increased from $158 million in 1980 to nearly $382 million in 1986.

Based on earlier reports, the President's budget submission for the crop year 1986 insurance operations reflects premiums for the reinsurance share at $320 million, and indemnities at $480 million, for a loss ratio of 1.50, with the remaining premiums of $80 million handled by master marketers. The direct indemnities are estimated at $139.2 million, which results in a loss ratio of 1.74. However, current estimates show premiums for reinsurance operations at $305 million with indemnities at over $460 million, for a loss ratio of 1.51, and $77 million in premiums handled by Sales and Service Contractors with direct indemnities currently estimated at about $132 million, which results in a loss ratio of 1.71. The combined efforts of the public and private sector show total premium amounting to over $382 million, and total indemnities of about $592 million, for a combined loss ratio of 1.55.

There have been several program and administrative changes for crop year 1986 made by the Corporation which should improve the crop insurance program.

Analysis and preparation for expansion in 166 additional county programs was conducted.

Implemented the Actual Production History (APH) Program for individualized coverage on all major program crops.

The Operations Automation Study initiated in 1984 was completed in F.Y. 1986. Accomplishments include the development of operations procedure and computer system design, programming, training, and first phase of operations implementation. Feasibility of the system was demonstrated.

Significant progress was made in updating the Actuarial Data Base.

Major recommendations made by the actuarial consultant, Milliman and Robertson, are being implemented.

A compliance review system of commercial insurance companies reinsured by FCIC, developed in 1985, is now operational.

A revised Agency Sales and Service Agreement for Master Marketers was signed, effective through June 30, 1987.

Significant achievements were made in automating office information systems, establishing microcomputer use, and telecommunications for all field offices and headquarters.

A formal Washington, D.C. level appeal process was established and is operational.

Refinement of procedures and follow-up systems for 30-day document processing were implemented.

Implemented a tracking system for updates and resolution of investigations, audits, and whistleblower cases.

Crop Year 1987 Projections

The fiscal year 1987 appropriations have permitted the Corporation to continue to expand the Federal Crop Insurance Program. In crop year 1987, insurance is offered on 41 major crops, on 19,219 county programs in 49 states and is available in virtually every agricultural county in the continental United States. Safflowers are authorized for coverage in the 1987 crop year along with new programs for Hawaii. Total insured acres are estimated at 58.6 million for the 1987 crop year, and premium is expected to be about $500 million.

The Corporation has also made several program and administrative changes effective for crop year 1987 which should improve the crop insurance program.

Current claims quality control information will be provided electronically in the field operations offices.

Implement a system for transmission of electronic insurance contract data by Sales and Service Contractors to begin in early July 1987.

Completion of a data base, data base management system, and analytical systems to support a computerized ratemaking system is anticipated ahead of schedule.

Develop a review system for the electronic transmission of insurance contract data by Sales and service Contractors.

Establish a system for electronic transmission of Actual Production History (APH) data from commercial companies through a private reporting channel to FCIC field actuarial offices.

Exhibits

I would like to have two exhibits inserted in the record. The first exhibit is a revised table of the 1986 crop year experience, by commodity, as of February 1987, and reflects the changes that have taken place since the submission of the President's Budget.

The second exhibit shows loss ratios during the 39 years of our existence. The crop insurance program has had 18 years in which premiums have exceeded indemnities and 21 years in which the reverse has been true. The 39-year loss ratio is 1.32.

This concludes my statement. We will be glad to answer any questions or furnish any additional information you may desire.

EXHIBIT I

ESTIMATED CROP INSURANCE EXPERIENCE - 1986
As of March 1987

ALL PROGRAMS
(Dollars in Thousands)

	Amount of Premium (a)			Amount of Indemnities			Loss Ratio		
	Government Operations	Reinsurance Operations	Total	Government Operations	Reinsurance Operations	Total	Government Operations	Reinsurance Operations	Combined
Wheat	18,469	51,374	69,843	28,702	89,151	117,853	1.55	1.74	1.69
Cotton	1,880	20,984	22,864	4,535	52,468	57,004	2.41	2.50	2.49
Combined Crop	193	0	193	213	0	213	1.10	0.00	1.10
Tobacco	4,829	8,797	13,626	9,881	13,722	23,603	2.05	1.56	1.73
Corn	16,754	84,632	101,386	18,026	63,474	81,499	1.08	0.75	0.80
Flax	117	396	513	201	792	993	1.71	2.00	1.93
Bean	918	4,301	5,219	1,060	5,248	6,308	1.15	1.22	1.21
Citrus	938	1,833	2,771	153	1,279	1,432	0.16	0.70	0.52
Soybean	13,647	58,998	72,645	25,453	106,197	131,649	1.87	1.80	1.81
Barley	3,329	10,284	13,613	5,739	19,289	25,028	1.72	1.88	1.84
Peach	558	931	1,489	1,740	1,806	3,546	3.12	1.94	2.38
Grain Sorghum	2,245	11,711	13,956	4,410	21,079	25,490	1.96	1.80	1.83
Oat	259	516	775	405	922	1,327	1.56	1.79	1.71
Rice	168	871	1,039	250	2,408	2,658	1.48	2.76	2.56
Raisin	309	7,070	7,379	1	284	285	0.00	0.04	0.04
Pea, Green & Dry	194	660	854	73	487	560	0.38	0.74	0.66
Peanut	4,070	12,101	16,171	15,110	33,454	48,564	3.71	2.76	3.00
Potato	956	2,368	3,324	1,995	8,130	10,125	2.09	3.43	3.05
Apple	1,099	2,698	3,797	2,973	7,032	10,005	2.71	2.61	2.64
Tomato	176	3,787	3,963	170	1,525	1,695	0.97	0.40	0.43
Sugar Beet	666	1,989	2,655	637	1,866	2,503	0.96	0.94	0.94
Grape	215	1,380	1,595	259	968	1,227	1.21	0.70	0.77
Sugarcane	34	600	634	0	0	0	0.00	0.00	0.00
Puerto Rico Reins.	0	0	0	0	0	0	0.00	0.00	0.00
Sunflower	680	2,809	3,488	1,293	5,617	6,910	1.90	2.00	1.98
Forage Seeding	2	2	4	0	3	3	0.00	1.50	0.79
Sweet Corn	66	200	266	38	71	109	0.57	0.36	0.41
Forage Production	0	1	1	0	0	0	0.00	0.00	0.00
Rye	4	9	13	4	5	9	0.95	0.56	0.68
Almond	379	1,829	2,208	2,069	11,659	13,728	5.46	6.37	6.22
Prev Planting	31	8	39	286	182	468	9.36	22.75	12.14
Hybrid Seed	440	6,207	6,647	482	3,203	3,685	1.09	0.52	0.55
Citrus Tree	3	647	650	0	58	58	0.00	0.09	0.09
Table Grape	75	888	963	41	851	892	0.55	0.96	0.93
Pepper	499	793	1,292	1,070	849	1,919	2.15	1.07	1.49
Popcorn	35	204	239	60	245	305	1.68	1.20	1.27
Tomato, Fresh	2,483	1,314	3,797	4,069	932	5,001	1.64	0.71	1.32
Walnut	12	97	109	17	298	315	1.45	3.07	2.90
Cranberry	0	389	389	0	471	471	0.00	1.21	1.21
Nursery Stock	0	0	0	0	0	0	0.00	0.00	0.00
Cotton, ELS	13	72	85	0	0	0	0.00	0.00	0.00
Sweet Corn, Fresh	12	399	411	0	651	651	0.00	1.63	1.58
Canning Peach	88	517	605	42	519	561	0.47	1.00	0.93
Prune	154	335	489	546	2,805	3,351	3.54	8.37	6.85
ALL PROGRAMS	77,000	305,000	382,000	132,000	460,000	592,000	1.71	1.51	1.55

FEDERAL CROP INSURANCE CORPORATION
REINSURANCE OPERATIONS

EXHIBIT II(A)

LOSS RATIOS - 1981-1986
CROP YEAR

PROGRAM	1948-80	1981	1982	1983	1984	1985	1986	1981-86	1948-86
Wheat		0.79	0.75	0.64	1.61	2.23	1.74	1.61	
Cotton		1.36	2.38	1.78	1.71	0.54	2.50	1.69	
Combined Crop		0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Tobacco		1.58	0.77	2.28	0.54	0.63	1.56	1.11	
Corn		0.38	0.53	2.62	0.87	0.59	0.75	0.82	
Flax		0.00	1.40	1.73	0.00	1.08	2.00	1.24	
Bean		0.11	3.06	1.35	1.03	2.06	1.22	1.62	
Citrus		0.00	0.34	0.00	3.43	4.59	0.70	2.14	
Soybean		0.68	1.17	1.96	1.99	1.79	1.80	1.81	
Barley		0.71	0.46	0.79	2.32	4.54	1.88	2.65	
Peach		0.00	2.33	3.47	0.49	3.24	1.94	2.16	
Grain Sorghum		0.97	0.95	1.73	2.41	1.58	1.80	1.80	
Oat		1.94	0.60	0.69	0.98	1.12	1.79	1.07	
Rice		0.00	1.71	3.47	1.47	2.50	2.76	2.41	
Raisin		0.00	0.00	1.20	0.53	0.15	0.04	0.63	
Pea		0.00	0.00	0.87	1.47	0.73	0.74	0.81	
Peanut		0.00	0.87	3.46	0.83	0.93	2.76	1.79	
Potato		0.00	1.10	2.60	2.05	3.29	3.43	3.01	
Apple		0.00	2.23	0.00	4.41	2.40	2.61	2.60	
Cherry		*	*	*	*	*	*	*	
Tomato		0.00	0.00	1.50	1.10	0.59	0.40	0.78	
Safflower		*	*	*	*	*	*	*	
Sugar Beet		1.38	0.00	0.69	0.73	0.89	0.94	0.80	
Tung Nut		*	*	*	*	*	*	*	
Grape		0.00	0.00	2.67	0.98	0.77	0.70	1.56	
Sugarcane		0.00	0.00	8.67	3.67	1.14	0.00	2.27	
P. Rico Reins.		*	*	0.31	0.38	0.00	0.00	0.35	
Sunflower		1.02	1.33	0.99	1.62	3.59	2.00	2.11	
Forage Seed.		0.00	0.00	0.00	0.00	6.00	1.50	2.25	
Sweet Corn		0.00	0.00	0.00	0.00	0.70	0.36	0.54	
Forage Prod.		2.00	0.00	0.00	0.00	18.00	0.00	6.67	
Rye		0.00	0.00	0.00	0.00	4.00	0.56	0.45	
Almond		0.00	0.00	3.78	0.00	0.64	6.37	2.10	
Prev. Planting			0.00	0.00	0.00	0.00	22.75	22.75	
Hybrid Seed				12.13	3.30	0.64	0.52	0.83	
Citrus Tree				0.00	24.99	0.97	0.09	5.54	
Table Grape					3.18	1.56	0.96	2.09	
Pepper					1.47	3.48	1.07	1.72	
Popcorn					4.41	2.59	1.20	2.82	
Fresh Tomato					4.41	5.69	0.71	2.60	
Walnut					0.00	0.00	3.07	3.07	
Cranberry					0.00	0.11	1.21	0.71	
Nursery Stock					0.00	0.00	0.00	0.00	
Cotton, ELS						0.00	0.00	0.00	
Sw Corn, Fresh						3.20	1.63	1.94	
Peach, Canning							1.00	1.00	
Prune							8.37	8.37	
ALL PROGRAMS		0.71	0.89	1.70	1.46	1.44	1.51	1.44	

* No Program.

(1) The crop year 1986 ratios are based on estimates as of March 1987.

FEDERAL CROP INSURANCE CORPORATION
GOVERNMENT OPERATIONS

EXHIBIT II(B)

L O S S R A T I O S - 1948-1986

PROGRAM	CROP YEAR								
	1948-80	1981	1982	1983	1984	1985	1986	1981-86	1948-86
Wheat	1.05	0.97	0.92	1.02	1.56	2.91	1.55	1.30	1.14
Cotton	1.57	1.10	1.80	1.66	0.94	0.48	2.41	1.43	1.52
Combined Crop	1.18	0.17	0.32	0.62	0.10	0.59	1.10	0.38	1.12
Tobacco	1.04	0.89	1.05	3.23	0.49	0.56	2.05	1.33	1.15
Corn	1.08	0.59	0.52	2.83	0.94	0.64	1.08	0.88	0.99
Flax	0.89	0.90	1.19	0.80	0.79	1.19	1.71	1.03	0.90
Bean	0.92	1.01	2.96	1.18	1.44	1.89	1.15	1.74	1.35
Citrus	1.40	2.23	0.05	0.00	2.40	2.78	0.16	1.62	1.45
Soybean	0.89	1.82	2.12	2.59	1.80	1.56	1.87	2.02	1.73
Barley	0.95	0.82	0.68	0.89	1.91	3.93	1.72	1.55	1.27
Peach	1.25	0.35	4.16	2.75	1.22	2.28	3.12	2.27	1.55
Grain Sorghum	1.05	0.93	1.23	2.31	2.61	1.95	1.96	1.55	1.34
Oat	0.84	1.39	0.61	0.80	1.08	1.72	1.56	1.14	0.95
Rice	1.47	1.86	3.38	4.09	1.47	2.00	1.48	2.80	2.39
Raisin	1.01	0.00	6.28	0.91	0.14	0.04	0.00	2.54	1.90
Pea	1.27	0.68	0.73	0.94	1.12	0.59	0.38	0.76	1.15
Peanut	1.35	0.62	0.79	2.93	0.86	1.09	3.71	1.41	1.39
Potato	2.06	1.36	2.07	2.83	3.40	1.79	2.09	2.38	2.31
Apple	1.27	1.54	1.55	1.76	1.05	3.10	2.71	2.05	1.59
Cherry	2.61	*	*	*	*	*	*	*	2.61
Tomato	0.75	0.40	2.62	1.11	2.17	1.51	0.97	1.72	1.44
Safflower	2.50	*	*	*	*	*	*	*	2.50
Sugar Beet	0.77	0.59	0.52	0.75	0.68	0.97	0.96	0.68	0.74
Tung Nut	0.74	*	*	*	*	*	*	*	0.74
Grape	0.99	0.85	2.28	2.46	0.58	1.04	1.21	1.81	1.55
Sugarcane	0.86	1.22	0.80	4.36	0.26	0.11	0.00	1.98	1.43
P. Rico Reins.	0.15	*	*	0.00	0.00	0.00	0.00	0.00	0.15
Sunflower	1.03	0.70	1.43	1.11	1.55	4.30	1.90	1.40	1.29
Forage Seed.	4.88	4.38	2.67	1.20	2.00	2.00	0.00	2.85	3.49
Sweet Corn	0.59	1.12	0.43	1.18	0.42	1.37	0.57	0.79	0.76
Forage Prod.	2.00	3.15	2.12	2.71	0.00	0.50	0.00	2.20	2.13
Rye	1.00	0.00	0.23	0.59	0.30	1.44	0.95	0.52	0.53
Almond		0.02	0.75	3.11	0.00	0.44	5.46	1.37	1.37
Prev. Planting			5.62	1.31	0.40	3.00	9.36	5.81	5.81
Hybrid Seed				12.03	2.38	0.81	1.09	2.15	2.15
Citrus Tree				0.00	22.91	0.00	0.00	9.49	9.49
Table Grape					1.21	0.83	0.55	0.97	0.97
Pepper					1.17	2.81	2.15	2.03	2.03
Popcorn					3.03	2.02	1.68	2.52	2.52
Fresh Tomato					7.07	5.76	1.64	3.65	3.65
Walnut					0.04	0.55	1.45	0.52	0.52
Cranberry					0.00	0.00	0.00	0.00	0.00
Nursery Stock					0.00	0.00	0.00	0.00	0.00
Cotton, ELS						0.00	0.00	0.00	0.00
Sw Corn, Fresh						0.14	0.00	0.05	0.05
Peach, Canning							0.47	0.47	0.47
Prune							3.54	3.54	3.54
ALL PROGRAMS	1.10	1.09	1.43	2.20	1.46	1.78	1.71	1.50	1.29

* No Program.

(1) The crop year 1986 ratios are based on estimates as of March 1987.

FEDERAL CROP INSURANCE CORPORATION
COMBINED OPERATIONS

EXHIBIT II(C)

PROGRAM	LOSS RATIOS - 1948-1986								
	CROP YEAR								
	1948-80	1981	1982	1983	1984	1985	1986	1981-86	1948-86
Wheat	1.05	0.97	0.88	0.87	1.59	2.44	1.69	1.43	1.24
Cotton	1.57	1.11	1.88	1.70	1.58	0.53	2.49	1.57	1.57
Combined Crop	1.18	0.17	0.32	0.62	0.10	0.59	1.10	0.38	1.12
Tobacco	1.04	0.89	0.99	2.96	0.51	0.60	1.73	1.26	1.14
Corn	1.08	0.58	0.52	2.74	0.89	0.60	0.80	0.85	0.93
Flax	0.89	0.89	1.25	1.08	0.34	1.12	1.93	1.12	0.92
Bean	0.92	1.01	2.99	1.28	1.14	2.03	1.21	1.68	1.45
Citrus	1.40	2.23	0.08	0.00	2.61	3.41	0.52	1.75	1.49
Soybean	0.89	1.80	2.01	2.47	1.90	1.72	1.81	1.94	1.75
Barley	0.95	0.82	0.63	0.85	2.14	4.35	1.84	2.11	1.77
Peach	1.25	0.35	3.60	3.08	0.81	2.80	2.38	2.21	1.69
Grain Sorghum	1.05	0.93	1.15	2.00	2.47	1.67	1.83	1.69	1.53
Oat	0.84	1.42	0.60	0.76	1.03	1.33	1.71	1.12	0.97
Rice	1.47	1.86	3.36	4.05	1.47	2.39	2.56	2.70	2.40
Raisin	1.01	0.00	6.28	1.14	0.48	0.14	0.04	1.16	1.13
Pea	1.27	0.68	0.65	0.92	1.28	0.69	0.66	0.78	1.09
Peanut	1.35	0.62	0.80	3.06	0.85	0.98	3.00	1.56	1.51
Potato	2.06	1.36	1.40	2.75	2.72	2.62	3.05	2.74	2.67
Apple	1.27	1.54	1.64	1.45	1.99	2.72	2.64	2.31	1.86
Cherry	2.61	*	*	*	*	*	*	*	2.61
Tomato	0.75	0.40	2.56	1.44	1.14	0.62	0.43	0.90	0.90
Safflower	2.50	*	*	*	*	*	*	*	2.50
Sugar Beet	0.77	0.68	0.35	0.73	0.71	0.92	0.94	0.74	0.75
Tung Nut	0.74	*	*	*	*	*	*	*	0.74
Grape	0.99	0.85	2.28	2.61	0.93	0.81	0.77	1.66	1.56
Sugarcane	0.86	1.22	0.80	5.05	2.58	1.00	0.00	2.09	1.62
P. Rico Reins.	0.15	*	*	0.31	0.38	0.00	0.00	0.35	0.32
Sunflower	1.03	0.72	1.40	1.06	1.59	3.79	1.98	1.70	1.57
Forage Seed.	4.88	4.38	2.40	1.20	2.00	3.33	0.79	2.78	3.39
Sweet Corn	0.59	1.12	0.39	1.18	0.42	0.83	0.41	0.66	0.65
Forage Prod.	2.00	3.07	2.12	2.71	0.00	6.33	0.00	2.42	2.27
Rye	1.00	0.00	0.16	0.59	0.30	1.70	0.68	0.50	0.51
Almond		0.02	0.75	3.50	0.00	0.62	6.22	1.84	1.84
Prev. Planting			5.62	1.31	0.40	3.00	12.14	6.62	6.62
Hybrid Seed				12.07	3.05	0.65	0.55	0.98	0.98
Citrus Tree				0.00	23.58	0.95	0.09	7.58	7.58
Table Grape					3.00	1.53	0.93	2.01	2.01
Pepper					1.33	3.26	1.49	1.84	1.84
Popcorn					3.98	2.50	1.27	2.76	2.76
Fresh Tomato					6.31	5.73	1.32	3.30	3.30
Walnut					0.04	0.55	2.90	2.26	2.26
Cranberry					0.00	0.11	1.21	0.71	0.71
Nursery Stock					0.00	0.00	0.00	0.00	0.00
Cotton, ELS						0.00	0.00	0.00	0.00
Sw Corn, Fresh						2.99	1.58	1.87	1.87
Peach, Canning							0.93	0.93	0.93
Prune							6.85	6.85	6.85
ALL PROGRAMS	1.10	1.08	1.32	2.02	1.46	1.53	1.55	1.47	1.33

* No Program.

(1) The crop year 1986 ratios are based on estimates as of March 1987.

ASCS SALARIES AND EXPENSES

Senator BURDICK. For fiscal year 1987, you are requesting a supplemental appropriation of $24 million for ASCS salaries and expenses. This request is due to the extremely high workload in the ASCS county offices and you indicate that you are currently working under a deficiency apportionment.

If this supplemental appropriation is not provided, when will you need to terminate temporary employees or institute an agencywide furlough?

Mr. HERTZ. Mr. Chairman and members of the committee: I think that we could approach it two ways. We could cut back on our temporary and part-time employment from this point forward, or whenever we knew that we would not get the supplemental appropriation, and budget the year out that way. Or, we could continue to provide the service and get the job done, as we are now, until about the second week in September, when we would probably just shut the agency down.

Senator BURDICK. Is $24 million still an accurate estimate?

Mr. HERTZ. Based on our best projections at this point, Mr. Chairman, it would be quite accurate.

Senator BURDICK. You indicate a decrease of $25,908,000 for your salaries and expenses due to several factors. These factors include a decrease in ADP activity, reduced commodity loan activity, no new disaster program, no new funding for conservation programs, and a decrease in administrative costs.

Please provide the amounts of money attributed to each one of these factors, if you can.

Mr. HERTZ. Mr. Chairman, I don't have those numbers at my fingertips, may I submit them?

Senator BURDICK. You may.

[The information follows:]

ADMINISTRATIVE EXPENSE REDUCTIONS

The proposed decrease of $25.9 million in fiscal year 1988 includes administrative expense reductions in both county and Federal offices. First, in county offices, the following workload reductions are estimated:

(1) Commodity program payment activity ($6.6 million);

(2) commodity loan activity ($5 million);

(3) the proposal for no new funding for ACP and other regular conservation programs and reduced fiscal year 1988 carryover funding for these programs ($6.8 million);

(4) yields and bases establishment activity ($2.7 million);

(5) SCOAP savings in maintenance of producer and farm records data and in farm tract establishment ($2.8 million);

(6) a decrease in the number of local administrative areas conducting ASC community and county committee elections based on enacted legislation ($1.6 million);

(7) no Emergency Feed Assistance Program activity ($1.5 million);

(8) fewer acreage reports and reduced compliance activity ($1.1 million); and

(9) fewer bin measurement service requests ($.4 million).

These estimated reductions of $28.5 million are partially offset by an increase of $4 million for carrying out the Conservation Reserve Program, with net reductions totaling $24.5 million in county offices.

The proposed reduction in Federal offices of $1.4 million is due primarily to a decrease in estimated workload in our Kansas City field offices and includes estimated reductions in staffing for activities related to the 1985 farm bill ($.3 million), lower loan processing requirements due to SCOAP ($.7 million), and lower ADP resources needed in support of SCOAP ($.4 million).

Combined Federal decreases of $1.4 million and county office decreases of $24.5 million total the $25.9 million included in our budget request.

COMMODITY LOAN ACTIVITY

Senator BURDICK. Do you expect reduced commodity loan activity?

Mr. HERTZ. Yes, Mr. Chairman. If you look at the corn program, there were nearly 2 million acres that were enrolled in the conservation reserve, plus the 15-percent paid diversion as part of the regular program. This would indicate that there will be somewhat fewer acres of corn planted, and therefore less loanmaking activity.

ADVANCE DEFICIENCY PAYMENTS

Senator BURDICK. The President's budget indicates that no advance deficiency payments will be made in 1988. Has this, in fact, been decided, or was this merely a proposal?

Mr. HERTZ. Mr. Chairman, at this point in time, it is our assumption that we would not make the advance deficiency payments for the 1988 crops.

Senator BUMPERS. Would the chairman yield for a question at this point?

Senator BURDICK. Certainly.

Senator BUMPERS. Could you tell us what were the advance deficiency payments in 1986, and how much is anticipated for 1987?

Mr. HERTZ. The advance deficiency payments that were made for crop-year 1986 were approximately $5.1 billion for all commodities, which included certificate payments.

Senator BUMPERS. What about 1987?

Mr. HERTZ. In 1987, I suspect that it would be close to that.

Senator BUMPERS. When are those payments going to go out?

Mr. HERTZ. The payments for 1987 have been made.

Senator BUMPERS. Were they made before the end of last year?

Mr. HERTZ. If the farmer signed up, advance deficiency payments were available to him, and we started signup for wheat on October 1.

Senator BUMPERS. Have all the payments been made that are going to be made?

Mr. HERTZ. To those farmers who have signed up, yes.

Senator BUMPERS. Isn't the signup period over?

Mr. HERTZ. No; it ends on March 30.

Senator BUMPERS. Thank you, Mr. Chairman.

Senator BURDICK. This decision on advance deficiency payments—do you think that this will have any effect on the farmer's ability to put a crop in this year?

Mr. HERTZ. Mr. Chairman, we have advance deficiency payments available for the 1987 crop year. We did make advance deficiency payments in a similar proportion to the 1986 advance deficiency payments.

Senator BURDICK. What about 1988?

Mr. HERTZ. That is where we have not projected a workload for making advance deficiency payments, nor have we included the funding that we would need to make the payments in the fiscal year 1988 budget.

FEDERAL CROP INSURANCE CORPORATION

Senator BURDICK. In the fiscal year 1988 budget, the administration stated that it would introduce legislation to privatize the Federal Crop Insurance Program, supposedly to eliminate the subsidy presently being provided to farmers, to include all administrative and operating costs in the premium rates charged to farmers over a 5-year period.

Is it true that under the proposal the federal government would still be responsible to fund the vast majority of program losses? If so, do you believe it is accurate to refer to the proposal as a privatization of the program?

Mr. FOSSE. Mr. Chairman, it is true that the proposal says to phase out all federal support with the exception of a premium-sustained catastrophic reinsurance facility. The connotation of premium-sustained is that if there are losses to be paid, they would be paid by the premium income received from the private companies seeking reinsurance.

Senator BURDICK. I understand that under the proposal, premiums charged to farmers will increase an average of $6 to $12 per acre. Has FCIC done any analysis to determine how this will affect farmer participation in the program?

Mr. FOSSE. We have done only the surface kind of analysis, Mr. Chairman. Looking at the distribution of the business by level of coverage, one might say that there is already in operation some recognition of cost. It would be reasonable to assume that if the cost of crop insurance would increase to that magnitude, there might be different decisions made on choice of coverage.

For example, in 1985, the latest year for which we have the data, about 48 percent of the producers elected the highest level of coverage, which is the highest price level of coverage; about 48 percent elected the middle level of coverage; and only 4 percent elected to get the lower price and lower level of coverage.

So there is some question of the effect of cost on the choice of coverage level already. How much the change in the program funding will affect participation is very difficult to estimate. It is reasonable to expect that there would be some change, at least there would be a change, perhaps, in the selection of level of coverage.

Senator BURDICK. You would have to have a crystal ball to know how many, but naturally, when you double the cost, it is going to get some dropouts.

Mr. FOSSE. Yes, sir; either that, or else there would be election of lower priced level of coverage. For example, the lowest level of coverage we offer, which by the way is roughly equivalent to the formula that disaster payments would pay out, is on the order of a fourth or a fifth of the highest level of coverage, yet we have producers, about half of them, electing the highest level and the highest price level of coverage, and not many of them are electing the disaster level of coverage.

Senator BURDICK. Senator Grassley.

Senator GRASSLEY. Thank you.

ASCS REGULATIONS

First of all, I want to thank the people of the department for changing the regulations on oats so that cross compliance didn't control, and we were able to facilitate farmers who wanted to plant oats this year to do that. That was a very timely decision that we appreciate very much. It was very positively responded to in our state, and I suppose in several states.

I would like to ask, first of all, in regard to an ASCS matter, will the Secretary use his discretion to move up the final payment of the 1986 deficiency payments?

Mr. HERTZ. Senator Grassley, we would need a change in the law before we could do that.

Senator GRASSLEY. For corn?

Mr. HERTZ. Yes.

Senator GRASSLEY. You need a change in the law?

Mr. HERTZ. The statute provides that the Findley portion of the deficiency be calculated on a 12-month marketing year.

Senator GRASSLEY. You have the authority to move up one-half of it, don't you?

Mr. HERTZ. We had enabling legislation last October that allowed us to do it with wheat only, which gave the Secretary discretionary authority to calculate the entire wheat deficiency on a 5-month marketing year. We did not get that authority for feed grains.

EXPORT ENHANCEMENT PROGRAM

Senator GRASSLEY. In regard to the Export Enhancement Program, considering that the funding authority is rapidly being utilized, and U.S. grains, particularly wheat, are priced at uncompetitive levels, does the Department have an alternative strategy to spur export sales?

Mr. AMSTUTZ. Senator Grassley, as the Department has said for quite some time, we have seen real signs that the Food Security Act of 1985 is working. By that I mean, Senator, that we see evidence that wheat plantings in other nations are declining. We are expecting a decline in wheat acreage worldwide, in particular, in the major producing countries of Canada, Australia, Argentina and the European Community.

We are enjoying these days, if that is the proper word, a resumption in consumption. I might add, Senator, that a principal reason for this is that more wheat is being fed, so it is kind of a mixed blessing. Nonetheless, worldwide the consumption of wheat this year is about 20 million tons higher than it was in 1984 and 1985. Twenty million tons is somewhere between 30 and 35 percent of the wheat we produce in this country, so it is a substantial amount.

We think that as we enter this next crop-year for wheat, supply and demand will be in better balance. That bodes a better situation for price, and a better situation for American competitiveness.

Senator GRASSLEY. I think you are saying that you don't see any need to expand the EEP at all.

Mr. AMSTUTZ. The EEP statutory provision mandated $1 billion over 3 years, and permitted $1.5 billion. We have been using the program actively, as I am sure the Senator knows. Actually on a CCC value of commodity basis, some $900 million of commodities have been awarded in subsidies. On a market basis, I think the figure is some $625 million. It is our judgment that there is some room there still.

Senator GRASSLEY. The European Community is taking some of our Russian market away from us. We can lay claim to it, and I think historically we have, at least compared to the European Community. Do you envision any broadening of the EEP to include Russia?

I know that for wheat, there was an offer made to them 6 months ago, but beyond that——

Mr. AMSTUTZ. You ask a difficult question, Senator.

Senator GRASSLEY. Is that because I am asking it today, or would it be just as difficult if I had asked it a month ago, because I am not asking you to louse anything up?

Mr. AMSTUTZ. It would have been difficult either a month ago or today.

Senator GRASSLEY. Then answer it today, if you will?

Mr. AMSTUTZ. I am going to have to answer you in shorthand, if you will bear with me.

There is, as the Senator knows, an existing agreement with the Soviet Union. There is clearly a difference of opinion about the obligations of the parties to the agreement.

It is important that I say here, again, that it is our judgment that the agreement clearly calls for the Soviet Union to buy specified quantities of corn and wheat every year, just as it requires the United States to make them available. The prices dictated in the agreement are prices in effect in this country.

Senator GRASSLEY. You are speaking about the 8 million metric tons, but what about beyond the agreement—if they would buy beyond the agreement?

Mr. AMSTUTZ. The agreement covers that, Senator. It gives them latitude to take up to 12 million tons with virtually no consultation, and has provisions for extending commodities beyond that. So the agreement encompasses full flexibility on quantities.

Senator GRASSLEY. You are taking the position that the U.S.S.R. has to buy from us at the world market price the first 8 million metric tons. But what about beyond that?

Mr. AMSTUTZ. I understand your point. I misunderstood you before. Your question gets into the second phase of my answer to your first question. For the record, I felt that I had to lay that out.

Senator GRASSLEY. I won't interrupt you.

Mr. AMSTUTZ. There is sometimes a difference between being competitive and being cheap. The issue in dispute involves the level of subsidy that was offered last summer and relates to the difference between being competitive and being cheap. I use the word "cheap" for graphic reasons, to make sure that I am pointing out a difference.

I think that there is a willingness to explore this subject if the issue is being competitive. I don't think there is a willingness to explore it on this side from the standpoint of being cheap.

Senator GRASSLEY. That was a shorthand answer. I may want further expansion on it, but I don't think I will go beyond that now.

I forget what the law says. Does it allow export enhancement money to be used for anything other than grain?

Mr. AMSTUTZ. Excuse me?

Senator GRASSLEY. Can the export enhancement money be used for anything other than grain?

Mr. AMSTUTZ. Yes.

Senator BUMPERS. I can answer that. It has been put on pork and poultry, but I don't know about anything else.

Senator GRASSLEY. Let me ask you, is it being used for any meat products?

Mr. AMSTUTZ. Yes.

Senator GRASSLEY. What about corn and soybeans?

Mr. AMSTUTZ. It has been used for soybean oil. It has been used for feed grains, but not for corn. Senator Grassley, our corn is competitive in the world market.

Senator GRASSLEY. We could have it be a little more competitive—it wouldn't hurt.

Mr. AMSTUTZ. The Soviet Union has been buying corn quite regularly these past months, for example. I think you can assume that were we not competitive, they wouldn't be buying the corn. But we are, and they are buying it.

Senator GRASSLEY. They could be buying it because they know something that we don't know. That is typical of where we are.

I am done for the time being.

Senator BURDICK. Senator Bumpers.

ASCS DEFICIENCY PAYMENTS

Senator BUMPERS. Mr. Hertz, first of all, I don't want to get into a diatribe about what happened in my state on these ASCS deficiency payments, but there is one thing that still disturbs me greatly and that is, just last Thursday or Friday, ASCS made a decision to provide relief in all of these cases that qualify, and yet they didn't make any provisions for notification.

As a matter of fact, I have a nagging suspicion that ASCS really doesn't want all of these farmers to know about that. I am told that in my state there is almost a deliberate attempt not to make it known that these farmers are now eligible for relief. Would you comment on that?

Mr. HERTZ. May I ask a question, Senator Bumpers?

Are you referring to those farmers who had implementation plans that were deemed not to be in accordance with the requirements, and yet had been approved by a county and a state office?

Senator BUMPERS. That is essentially right. You had 750 farmers held in abeyance in my state until ASCS and OIG both agreed on whether they were entitled to relief or not. You know, we had a couple of meetings over in Senator Pryor's office about that. Do you remember all of that?

Mr. HERTZ. Yes, of course.

Senator BUMPERS. I thought you were wrong from the very beginning, especially in those cases where those people had been approved. They didn't form separate entities without prior approval, yet they were held up for a very long period of time.

Now I am told that a decision was made on Thursday or Friday of last week, and that you are going to provide total relief, but you are not going to send any instructions to the state to communicate to the farmers who are eligible for this relief, and they will just have to depend on word of mouth to know that they are going to get relief.

Mr. HERTZ. Senator, if word has not yet gotten to the county offices about how we are going to dispose of this, it certainly is on the way.

The decision we made, as you indicated, is, that people who did have an invalid plan, but were told that it was acceptable and farmed according to it will receive payments. For the most part, those farmers who are still awaiting payments have gone through the appeal process, and it will be just a matter of an administrative action to facilitate payments to those who have valid claims.

Senator BUMPERS. It is my understanding that farmers whose payments have been suspended have to ask for a reconsideration, with the understanding that it will almost automatically be granted. I just want to make sure that every farmer who is in the category of being entitled to relief gets notice that he is entitled to that relief.

Mr. HERTZ. We will see that that is taken care of, Senator.

Senator BUMPERS. One other question, and that is, there are some farmers who felt that they were not going to be eligible and didn't appeal these decisions. Some of them didn't apply because they were afraid that they would be charged with fraud, and so on, even though some of those cases were meritorious.

You have a list of everybody in the files in Little Rock, for example, including the farmers who would be eligible even though they didn't appeal, and you are withholding the money from them. Are you going to send anything to them?

Mr. HERTZ. I would suggest, Senator, that we would treat all of the meritorious cases all in exactly the same way.

Senator BUMPERS. I think that I am going to put out a press release on this, just in case they don't get the word down there from ASCS up here. I must say, I don't have much confidence in the Washington ASCS, based on what has happened in my state. It has been a real

Donnybrook down there. This situation has created a tremendous burden on a lot of farmers. It should have been disposed of so much sooner than it was.

I am not defending anybody who perpetrated a fraud. Maybe there were some frauds. You started that investigation in August 1985, and you started withholding payments in the summer of 1986. It has almost put a lot of farmers under. It probably did put some farmers under. I am going to advertise it in the hope that all the farmers who are entitled to relief will get it.

PRICE OUTLOOK

Let me ask you another question. How is the loan price right now compared to the cash price of soybeans in this country? Do you know the answer to that?

Mr. HERTZ. I think that they are fairly close. In fact, the cash price is above the loan price in many cases.

Senator BUMPERS. Does that mean that the Commodity Credit Corporation is not out anything on soybeans right now?

Mr. HERTZ. No, sir. I am sure that there are a lot of soybean loans that are still in place. What it does suggest, however, is that if the market price is higher than the loan, there is a good chance that a lot of those loans will be repaid.

Senator BUMPERS. What is the world outlook on cotton, rice, and soybeans for 1987 and 1988? Mr. Amstutz, can you answer that?

Mr. AMSTUTZ. I don't think that any of us at this table would claim to have the answer, Senator.

Senator BUMPERS. You make projections all the time on this. Just give me the projections.

Mr. AMSTUTZ. In general, the price outlook for cotton has been and continues to be quite good for 1987. My own hunch, based on what I have seen, is that there will not be much change in the price of rice.

For soybeans, concern that the relatively high loan level in this country—high relative to other products competing for the same acreage—will create problems for U.S. soybeans because it, in a sense, provides a price umbrella over producers in other countries, and raises concerns about what kind of a supply response we will get from that around the world.

It is not a very succinct answer, and I hope I am communicating.

PRICE SUPPORT PAYMENTS

Senator BUMPERS. In your testimony, or Mr. Hertz's testimony, you state that we spent over $25 billion in 1986 on price supports. Does that include deficiency payments, as well as loan prices?

Mr. AMSTUTZ. Yes.

Senator BUMPERS. My question is this: No. 1, what is the biggest item in that? Is it corn? Is it wheat? What commodity costs the government most to support?

Mr. AMSTUTZ. For 1987, estimates are: Feed grains and feed grain products, $13.1 billion; wheat and wheat products, $3.7 billion; rice,

$830 million; cotton, $1.4 billion; dairy, $1.3 billion; and soybeans, $800 million.

Senator BUMPERS. Soybeans is how much?

Mr. AMSTUTZ. It is $800 million.

I have another set of figures, though, Senator. If I could give you a per acreage figure, a per planted acre figure, it is sometimes more realistic.

Senator BUMPERS. All right.

Mr. AMSTUTZ. The estimates for 1987, outlays per planted acre are: Corn, $135.44——

Senator BUMPERS. Are you telling me that this is the government cost?

Mr. AMSTUTZ. Yes; federal outlays.

Senator BUMPERS. We pay $135 for every acre of corn grown?

Mr. AMSTUTZ. Planted.

Senator BUMPERS. Planted.

Mr. AMSTUTZ. Yes.

Senator BUMPERS. Go ahead, that is interesting.

Mr. AMSTUTZ. For wheat, $60.30. Again, these are estimates for 1987.

Senator BUMPERS. OK.

Mr. AMSTUTZ. For upland cotton, $73.24; for sorghum, $54.38; for barley, $27.41; for oats, $2.31; and for rice, $403.87.

Senator BUMPERS. That is meritorious. I didn't even want to hear that one. [Laughter.]

All of the figures you gave me come to about $20 billion. Does that mean that the rest of it is taken up in deficiency payments? How much do we put out in deficiency payments?

Mr. AMSTUTZ. These are outlays.

Senator BUMPERS. Does that include both?

Mr. AMSTUTZ. Yes.

Senator BUMPERS. Where is the other $5 billion?

Mr. AMSTUTZ. I just didn't read them all off to you, Senator. I can leave this detail with you, if you would like.

Senator BUMPERS. You don't see any change in corn for 1987; is that correct?

Mr. AMSTUTZ. Perhaps it would help to clarify that. When Mr. Hertz stated that he thought there would be less loan activity, he was referring to fiscal year 1988. Our estimate for outlays for feed grains, as I mentioned, Senator, in fiscal year 1987 is $13.1 billion, compared to our estimate for outlays in fiscal year 1988 for feed grains of $10.4 billion.

Senator BUMPERS. That is in 1988?

Mr. AMSTUTZ. Yes; for wheat the estimates are quite close.

Senator BUMPERS. How many acres of corn do you estimate will be planted this year?

Mr. HERTZ. About 68.5 million acres.

Senator BUMPERS. How many acres of rice?

Mr. HERTZ. About 2.3 million.

Senator BUMPERS. In giving me these figures of $403 for rice, and $135 for corn, for example, if a farmer has deficiency payments coming on both rice and wheat, and he is getting half and half, say, he gets $25,000 on wheat and $25,000 on rice, do you work just that part that he is getting on rice into this figure? How do you separate those two?

Mr. HERTZ. We determine the amount of deficiency earning per commodity crop based on his yield and his base, and the projected deficiency. We would do that on both crops, and the sum of the two would be his accumulated earnings. In the case of the $50,000 payment limit, if the sum of either of those commodities or the two together total more than $50,000, we would just pay the $50,000. We would not say that we paid half for rice and half for corn.

Senator BUMPERS. You don't separate those?

Mr. HERTZ. No; just the $50,000 payment is made.

[CLERK'S NOTE: The following response was provided for clarification:]

For accounting purposes, payments are applied on a first-in, first-out basis. Wheat payments are made first—by December—prior to the February due date for rice. If $40,000 is paid out for wheat in December and the same farmer is eligible for $30,000 in rice payments in February, he would receive $10,000 for rice—having reached his $50,000 payment limit—and only $10,000 would be applied to total rice payments.

Senator BUMPERS. Mr. Chairman, I thank you for your indulgence.

Senator BURDICK. Senator Kasten.

Senator KASTEN. Mr. Chairman, thank you very much.

CCC BUDGET PROPOSAL

First of all, I just want to make a brief comment on one part of the administration's budget proposal, the budget proposal for the CCC. Every year, the CCC runs out of money. You have pointed out in your statement that it is going to happen again this year in maybe even less than 6 weeks.

Every year, therefore, we have a supplemental. Every year that supplemental becomes a Christmas tree for other legislative proposals, and that means that we end up with all sorts of changes that you have to digest, that your people in the field have to digest, the farmers have to digest, and before we even have one program in place, we start in with another program.

I don't think that there is anything that we do—and I say "we," because I mean you and us—that frustrates the people throughout our state of Wisconsin, and I would guess every other state, than the continual changes that we are always making in the farm programs.

We have changes, and we have delayed regulations. Then we beat you up for not getting the regulations out to your field staff. We beat up the field staff people because they haven't had a chance to get the regulations out to the farm community. When we finally seem to have things organized, another legislative vehicle comes along, such as the supplemental, and we change everything again.

I just want to say that I applaud the proposal that is included in this budget now to remove at least this one opportunity to change course in midstream. Instead of having this emergency legislation, that we always need for the CCC, to instead give the CCC permanent, indefinite borrowing authority, which will mean that you will take one legislative train, if you will, off the track. It doesn't mean that there won't be some others, but I think that it is a step in the right direction. I applaud your leadership in this effort.

As you know, the Conservation Reserve Program, which is working so well, will be funded out of the CCC in fiscal year 1987, and through a direct appropriation in 1988. The 1987 estimate is $700 million. The 1988 budget estimate is $1.388 billion.

My question is this, we had a very large signup, over 10 million acres, in February. I think all of us are pleased with that; as a person who has been working with this legislation over the past couple of years, I certainly was. With the 10 million acres signed up in February and the prospect of additional signups later in the year, is there a possibility of the CRP exceeding the $1.388 billion figure which you have budgeted for 1988?

I guess another way of asking that is, what assumptions did you make in terms of the conservation reserve in arriving at that $1.388 billion figure?

Mr. HERTZ. Senator, the assumptions that we made were that we would have signed up fewer acres than we have actually signed up at this point.

May I first of all address the reference that you made to the $700 million for the cover crops in fiscal year 1987. The worst case scenario, if actual costs exceed our budget estimates, is that we would have to wait until fiscal year 1988 to make some of those cost-share payments.

We see some indication that grass seed is very expensive and hard to come by. It could be that some of the cover crops will not go on until next fiscal year, so that may not be a funding problem. If there is, we may have to delay some of the cover payments.

Overall, based on the extra acres that we have signed up at this point in time, we could be at least $100 million short.

Senator KASTEN. I would like, if I could, to work with you between now and the time that we actually mark up this legislation, because I think that it is important that that dollar figure be as good as we can possibly make it. We don't want to do anything to discourage what we now see as a real coalition coming together with agriculture interests, conservation interests, environmental interests, and others, all working together in this conservation reserve effort.

I think we don't want to see us coming up short, and I know that the committee is supportive of this program. We want to work very closely with you so that we have as correct an estimate of the cost of this program as we can.

Mr. Chairman, I have some other questions that I would like to submit for the record.

Thank you, Mr. Chairman.

Senator BURDICK. Senator Cochran.

Senator COCHRAN. Thank you, Mr. Chairman.

Let me join you in welcoming the members of this panel to our hearing today. We appreciate your cooperation with our subcommittee in providing us with the statements that you submitted to us, and the opportunity that we have to ask questions at the hearing.

CCC PAYMENT LIMITATIONS

I have one question that I want to explore the answer to that involves the issue of payment limitations. There has been a good deal of discussion about payment limitations—the $250,000 limit that was imposed through legislation last year on the continuing resolution—about the suggested guidelines that have recently been issued to those who are in the county and state offices, and about how to apply the new provisions.

What concerns a lot of people in my state is that regulations had been issued, and then on March 2 a purported effort to clarify the regulations was issued. I noticed that March 1 was the signup date for the program, although that has been extended to April 1. But into the county offices comes this directive or a notice, CM–90.

This has a lot of people confused, because a reading of CM–90, under a list of questions and answers that are attached as an exhibit to this notice, would indicate that a lot of those who were eligible as a person, for example, under current regulations, should not be considered an eligible person.

It seems unfortunate to me that this confusion is being generated or created at a very unfortunate time—during an extension of time to sign up. It seems as though the rules and the definitions are being changed or people are being confused right here at the last minute.

Are folks misreading these things? What is your reaction to that?

Mr. HERTZ. Senator Cochran, let me respond to that with, perhaps, some background.

We had an OIG audit in eight states that started in the summer of 1985 and progressed until we got a report just recently. The summary of this investigation suggests that in many areas of the country, we were not doing a very good job of administering the payment limitation, especially from the person determination aspect. What we did following that was to hold a series of educational training meetings.

I think the visibility that we got from the press—you could say the ridicule from a lot of people—for the way we were administering the program, has spilled down to every county, and they are saying, "We are going to do this thing right."

The list of questions and answers that you have were developed as questions would come in relating to a specific. We would respond to that specific, and we finally just started keeping track of those.

I can tell you very sincerely, Senator, that any regulations or directions that we provided about the payment limitation didn't change a thing. But the clarity that we provided to the countryside suggests that we totally changed the way we determined persons.

I think that we have gotten the word out to those people that we will use a common sense, a common ground approach to that, and we will get through this year in making those person determinations.

Senator COCHRAN. I have just glanced down through the list, and I certainly don't know enough about the details of the administration of the program to take issue with any of the questions and answers that are in the exhibit. However, it does concern me when I see there was an effort to define when title passed to a new owner under a certain instrument.

For instance, on page 1 of the exhibit, I guess it is the fifth question. The question is, "Is there any difference in contract for deed and deed of trust?" The answer is, "When a contract for deed is executed, the title to the property does not pass to the new owner until the entire amount of the purchase price has been paid. When a deed of trust is executed, the title to the property is immediately passed to the new owner."

I don't have any trouble with the first part of that answer, but the second part of that answer bothers me, because in Mississippi, for example, a deed of trust is the same thing as a mortgage, and title doesn't pass to the new owner until foreclosure occurs on the deed of trust. It is a mortgage. You are conveying title, but not, in effect, passing the ownership of that land to somebody. You are basically giving it to a trustee, not a new owner.

I get worried. I glance at that one, and I say, if this is being distributed as the law of the land that everybody ought to go by, and if they are going to be making determinations on whether a person who holds a deed of trust is going to be classified as an owner of the fee title of the land, they are going to be making a gigantic error if they make that determination in my state.

I don't know a lot about the administration of the details, but I hope that someone in your office will review these questions and answers and be sure that they are not inconsistent with current regulations or current law. I think that that is the problem.

Some people are telling me that these questions and answers are different from the regulations they are clarifying. I don't know whether that is true or not, but that is what I am told. Therefore, I thought I would bring that to your attention today and urge you to look into it. If there are any inconsistencies between the questions and answers in this CM-90 that has been sent out and current regulations or the current law, they should be clarified and that word should be sent out.

Mr. HERTZ. I can tell you, Senator, that the origin of these questions was the county offices out in the field.

CONSERVATION RESERVE PROGRAM

Senator COCHRAN. The 1985 farm bill that we passed, provided that at least one-eighth of the number of acres of land signed up for the conservation reserve would be planted to trees.

I don't know how it is in other parts of the country, but a lot of the erosion problems and the difficulties in agriculture are caused by a lot of land being put into cultivation that never should have been in the first place. It should be in pine trees, wildlife habitat, or some other conserving use of that type.

I noticed that the figures show that for the first through fourth signups a little over 1 million total tree acres have been contracted out of the almost 19 million acres which have been accepted. Is there going to be any way for us to get more of this land into trees, or is that an unrealistic expectation that was reflected in the Food Security Act?

Mr. HERTZ. Senator Cochran, I think that we will have to wait and see what kind of cover goes onto these last 10 million acres. At this point, of the acreage in your state that would be going into the reserve, we do not know what percentage will be planted to trees.

Senator COCHRAN. Is it the intention of the Department to encourage compliance with the Food Security Act, which suggests that there ought to be no less than one-eighth of the number of acres of land placed in the conservation reserve devoted to trees?

Mr. HERTZ. Yes.

Mr. AMSTUTZ. Senator, if I might add this. We have had a number of meetings with all interested sectors in this conservation reserve effort, and one message that has been clear is that we have to do a much better job of education and sale in this particular area.

All of us who are involved are confident that the program should be attractive for trees. We are just going to have to do a better job of selling that, and a better education, because that is the one area, Senator Cochran, where the participant in the program is allowed to harvest the crop. So it makes sense.

Senator COCHRAN. Thank you very much. I appreciate your response.

Senator BURDICK. Senator Sasser.

Senator SASSER. Thank you very much, Mr. Chairman.

Mr. Hertz, let me welcome you and your colleagues before the subcommittee here today, and just make one observation. The cost of storing the vast Commodity Credit Corporation surpluses is one of the largest outlays in all of the USDA's budget.

TEMPORARY EMERGENCY FOOD ASSISTANCE

I understand that you are requesting a supplemental appropriation of $6.7 billion. It may be necessary, but I see programs such as the Temporary Emergency Food Assistance Program, which provides food assistance to low income and elderly individuals, and which reduces the CCC surpluses, being zero funded, cut out.

Programs like the Temporary Emergency Food Assistance and Public Law 480 help to reduce these surpluses, while feeding hungry people here and other places. Shouldn't we place more emphasis on these programs which serve the dual role of reducing surpluses, while providing hunger assistance?

Also, does the Department of Agriculture have any plans for reducing these tremendous surpluses?

Mr. AMSTUTZ. Senator, I am checking on the Temporary Emergency Food Assistance Program, because you surprised me with your question.

Senator SASSER. The acronym is TEFAP.

Mr. AMSTUTZ. Yes.

Mr. SHERMAN. The $50 million proposed for elimination in the TEFAP program is the cost associated with reimbursing the states and local areas for distribution from sites where the food is delivered within the state to the individual sites where the people pick up the food.

There are over $1 billion of commodities, and the cost of processing them to prepare them for individual use, and the cost of shipping them to individual sites throughout the states, continue to be borne by the federal government. There is only a small portion of this program, which the administration felt should be borne locally, that is proposed for elimination. All commodities are still going out.

Senator SASSER. My point is this. From the experience of dealing with the agencies that handle these TEFAP commodities, the states and the local governments in many areas are unwilling or unable to come up with the funds to pay for the distribution to the agencies which make the ultimate distribution to the needy people.

They have indicated to me that if USDA cut out that portion of the funding that pays for distribution to the agencies—the state or local agencies, or private agencies—they are simply not going to make the distribution.

It appears to me that if we are going to pay the cost of storing these surplus commodities, if we are going to pay the cost of transportation for getting them into certain areas, after going the last mile, why not go the last foot or two to see that these commodities are distributed?

Mr. AMSTUTZ. Senator, I will look into this particular matter. None of us here has direct responsibility for this distribution. We will get back to you on it.

Two points, and that is why I was surprised at your question, because my recollection is that we are still funding this program in a substantial way. I think that this relates to some of the distribution charges that were deemed appropriate to move back to the local entities. Nonetheless, we will get back to you on that.

Over and above that, Senator, we think the best programs to deal with the stocks are programs that will finally put us in a position where we are not adding to stocks any more. Once we reach that position, history proves that we draw down stocks very rapidly. Witness the case in dairy today. Once we have programs in effect that no longer allow additions to stocks, we will draw them down very rapidly.

Senator SASSER. Let me just say, I think Mr. Sherman put his finger on it a moment ago when he said that there is a zeroing out of the state's portion of the program. What did you say, Mr. Sherman?

Mr. SHERMAN. The costs associated with the local distribution from the delivery site within the state to each point where the people are actually coming and picking up the surplus commodities.

Senator SASSER. For example, in my state, it could be the cost of taking the goods from Nashville, TN, for example, to Jackson, TN, which is about 100 to 150 miles.

Mr. SHERMAN. It could be from a site in Jackson, TN, to the local church, or the local institution that is giving out the commodities.

Senator SASSER. My point is, in either case, whether you are transporting the commodities 150 or 200 miles inside a state, or simply taking them from a distribution point inside a city to a distribution at another point in the city, what I am being told by agencies, by local government, and by our state government is that they simply don't have the funds to do that. If USDA zeroes this part of the program out, they are not going to be able to distribute the commodities.

The problem then is that the commodities are still there, and you have hungry people on the other end who could use them. Returning to my original statement, if we are going to go the last mile, why not go the last foot to make sure that we get rid of these commodities in a way that is helpful all the way around?

MARKETING STRATEGY

Let me just return to the statement that you made a moment ago about programs that would push us in the direction of drawing down on the commodities. Are we talking in terms of production control?

Mr. AMSTUTZ. No; the administration is not in favor of production control programs, Senator. What we are talking about, though, is the level of production incentives that are such that they are market oriented, so that the signals that are going out there are to produce for the market. It is a grossly oversimplified statement, but I am sure you understand what I am trying to say.

Senator SASSER. We are going to let the market solve this problem of surpluses?

Mr. AMSTUTZ. Yes and no. There, again, Senator, you ask an all-encompassing question with very few words. From an international standpoint, we are absolutely committed to the process now underway, the Uruguay Trade Round. We are committed to getting a meaningful resolution of the issues of subsidization, access barriers, and animal and plant health regulations.

We feel that if we can achieve our objectives in the subsidization area and the access barrier area of first freezing current operations and then phasing them out by a certain date, and if we can achieve the reality of harmonizing animal and plant health regulations around the world—and all things are possible, Senator; they are not easy, but possible—we would finally have reached agreements around the world whereby comparative advantage would work, and the trade playing field would finally be level. We think that this is enormously important for American agriculture and for world agriculture.

Senator SASSER. How long do you think that this is going to take?

Mr. AMSTUTZ. How long do I think the negotiating process is going to take?

Senator SASSER. This millenium that we are going to reach where we are playing on a level playing field with agricultural products worldwide. How realistic is that expectation?

Mr. AMSTUTZ. I think we can reach agreement in calendar year 1988.

Senator SASSER. I would be stunned if that were the case. I went to Japan a few years ago, and I had occasion to meet with Mr. Nakasone about the problem of encouraging the Japanese to buy more American tobacco. I didn't get very far. I got a lot of nice statements about a lot of good intentions, but as far as purchasing more American tobacco, there hasn't been a lot of movement.

While there, Mr. Chairman, I saw the most unusual demonstration you have ever seen of thousands of Japanese farmers marching in lockstep in what looked like regimental formation, as far almost as the eye could see, demonstrating against the lowering of Japanese agricultural tariffs or quotas so that more American products could get in. I think in this instance it might have been U.S. citrus.

Mr. AMSTUTZ. Beef and citrus.

Senator SASSER. How in the world are we going to reach a situation where we can have a level playing field internationally?

I think that if we are going to move in the direction of the hope of a market-oriented world economy in which there is no protection, there are no quotas, if that is going to be our plan for getting rid of our surpluses; I just don't think that is going to work. Historically, it appears to me that governments are more jealous in protecting the agricultural sector of their economy than they are any other sector of the economy.

Mr. AMSTUTZ. There is no question, Senator, that this has been the tendency, and there is no question also that you raise the classic example of the problem of meaningful negotiations—that classic example being Japan and their reluctance to put on the table the market access issues. But the fact is, Senator, it is essential that they do that.

Senator SASSER. Essential to whom? Is it essential to us but not to them?

Mr. AMSTUTZ. It is essential to us, to the rest of the trading community, and in the final analysis, to them. This is the message that we have to make sure they understand. If they want to live in this trading world, you have to give if you want to get. If you want to market products that you manufacture or produce all around the world, you have to permit others to do the same in your own country. You can't have a one-way street.

I understand, with Japan in particular, that question of market access is almost a cultural issue. But the fact is that we do see movement in those areas, Senator. We are confident that we are going to have a meaningful, comprehensive negotiation.

Senator SASSER. I wish you well, and I hope that you have great success. I must say that I am not overly optimistic, but you may do better than I think.

Mr. Chairman, I have additional questions, which I would like to submit for the record. Thank you.

Senator BURDICK. Senator McClure.

SODBUSTER PROVISION

Senator McClure. I am greatly concerned with the implementation of the sodbuster provision of the Food Security Act of 1985. There are several aspects to my concerns, but one in particular. The Soil Conservation Service works in conjunction with the ASCS to administer the program.

I know farmers who have told me that when they go to the SCS, they work out a soil conservation plan which meets the requirements of sodbuster, but when they go to ASCS to sign up for the program, they are told that they don't qualify. What is ASCS doing to make certain that there is coordination between ASCS and SCS so that farmers who attempt to comply can do so?

Mr. Hertz. Senator McClure, certainly we should all be working from the same page in determining the sodbuster provisions. The technical work related to the soil is entrusted to the Soil Conservation Service, and I don't know that we in ASCS are in any position to challenge or question that. I would hope, really, that we are not. If our sister agency is making recommendations for a farm plan, or what is included, we would accept them.

Senator McClure. You think that the situation that I have outlined is either inaccurately conveyed to me, or there is something wrong out in the state?

Mr. Hertz. I would suggest probably both, Senator.

Senator McClure. Will you work with me to try to get that straightened out?

Mr. Hertz. Yes, sir.

Senator McClure. I am concerned, too, that the 1985 provisions went beyond the original concept of sodbuster, which was the question of breaking out virgin land into cultivation, but even to the area of getting lands out of cultivation that are highly erodible acreage.

Do you agree with me that we cross that watershed in that act, and in the regulations that have been adopted pursuant to the act?

Mr. Hertz. Yes; I think that to attack the highly erodible acreage is the overriding theme of the entire conservation title of the act.

Senator McClure. I am concerned that that may well lead to farmers not being able to meet the criteria as they are now being implemented in the field to the point where they will either not be able to comply with the program, and they will have to go completely out of production, or change their pattern of cropping completely. Is that a possibility under the current situation?

Mr. Hertz. In a very, very extreme case, possibly. Where no plan can possibly work to stop the erosion, it is possible.

Senator McClure. What does that do to farm economics? Let me turn that around. A conservation plan may well change the economics of the operation; is that correct?

Mr. Hertz. Yes, sir.

Senator McClure. A number of highly erodible acres may render a marginally economical farming unit uneconomical.

Mr. HERTZ. I think what you will find, Senator, in the cases where there is a high level of erosion, a good conservation plan, even though it may change the entire operation of a farm unit and even reduce the number of acres that are tilled, will enhance the profitability of those acres substantially.

Senator MCCLURE. That can be, but what if it isn't, do you have latitude under the law and regulations to work with local farming units, and individual farmers, to see that the operation isn't rendered uneconomical?

Mr. HERTZ. First of all, let me say that our mission is not to create economic chaos out in the countryside in order to comply with the conservation title of the act.

Senator MCCLURE. That is not the purpose.

Mr. HERTZ. I feel that we have a good working relationship with the Soil Conservation Service. The chief of the Soil Conservation Service is a commonsense individual.

I think, using that approach, there are going to be some changes in probably the application of farming methods, possibly even the crops farmers can grow. But I think, working with the farmers, our agency and the Soil Conservation Service can make it work. I don't think that we are going to have those unique situations that totally put people out of business.

Senator MCCLURE. One of the things that does happen and is happening right now, is one of the cropping practices that you put in to reduce the amount of erosion on some acres—periodic planting of grass or alfalfa. If you plant grass or alfalfa, you can never take it out again.

Mr. HERTZ. I believe we are saying now, Senator, that if a farmer has a grass or alfalfa rotation in his farming plan at this point and if a soil conservation plan is in place on that land, some of the land could be plowed up.

What I am saying is that the final plan approved for the entire unit may call for a different configuration or rotation plan from that which is on the land now. If that is the case, implementation of the plan would not be called sodbusting.

Senator MCCLURE. If the plan permits it to be taken out, it is not sodbusting. If the plan doesn't permit it to be taken out, it is called sodbusting.

Mr. HERTZ. That is right.

Senator MCCLURE. It is all in the eyes of the government who decides whether it should be plowed or not?

Mr. HERTZ. I could express that concern to my sister agency.

Senator MCCLURE. Up in the Palouse area in northern Idaho, there are some areas where 25 to 28 percent of the land is classified as highly erodible. Are you going to take 25 to 28 percent of the land out of the traditional production, and tell that farmer that he is going to be better off?

Mr. HERTZ. No, sir; I don't believe that is the approach the conservation plans will take. I think the plan may require that alternate or additional conservation practices be installed on a percentage of the land. The program's mission is not to take all of that land out of production.

Senator McCLURE. I am very much concerned because, obviously, the farmers have not yet worked their way through that. But they certainly don't see in practice that what you are stating is the purpose. I think they would like to see in practice, coming out the other end, what they might applaud in terms of your desire. They don't think that it is happening that way.

Mr. HERTZ. I would be the first to admit, Senator, that we have had some problems around the country of being somewhat over-anxious, if you will, in trying to make the country look like it might have 400 years ago. That is the economic impact that we certainly want to avoid.

CONSERVATION RESERVE PROGRAM

Senator McCLURE. I want to compliment ASCS for responding to my inquiry as to the criteria to be used in the fifth Conservation Reserve Program. I understand that both the old criteria of "T" and the new criteria of VI will be used. It certainly helped, and I very much appreciate the attention that you gave to this problem.

I continue to hope that I will hear a positive answer to another request that I sent to the Department recently. I am in favor of granting Power County, ID, the ability to increase the allowable acreage to be entered into the CRP above 25 percent. They have requested an increase to 28.3 percent of the total land in the county. Can you tell me when that decision will be made?

Mr. HERTZ. Senator McClure, in those cases where counties exceed the 25-percent maximum in the conservation reserve per the statute, the Secretary does have discretionary authority to allow a higher percentage.

What we have wanted to do, to recognize the agribusiness industry in those particular counties, is to go into the county and do a survey with the financial institutions, the fertilizer dealer, and the seeds people. If we get a favorable response, in this case with your concurrence—yes, we would approve that additional acreage in the conservation reserve.

Senator McCLURE. The county has already supplied that information.

Mr. HERTZ. I don't know the status of this particular request, but I will certainly check on it.

Senator McCLURE. All right.

Another county in Idaho has also asked to be increased to above 25 percent. They were originally granted that authority. They had the authority, and in the first signup, they didn't go over 25 percent. They now could and want to go back up to the amount that was granted in the original authority, and they are not being given that authority. That is Oneida County. I wonder if you would look at that as well?

Mr. HERTZ. Yes.

[The information follows:]

Recently, Power County was granted authority to exceed the 25-percent cropland limitation. Power County was assigned a new limit of 28.73 percent of the cropland in the county which amounts to 109,861 acres.

In July 1986, Oneida County received authority to enroll up to 35 percent of the county's cropland in the CRP. As a result of raising the 25-percent limitation, there were 72,500 acres of cropland in Oneida County accepted in CRP, which amounted to 32.95 percent of the cropland in the county. Since the 25-percent cropland limitation has been exceeded, the county is not authorized to hold future CRP signups.

DAIRY TERMINATION PROGRAM

Senator McCLURE. The Dairy Termination Program was heavily used in Idaho, as it was in some other places as well, but there is a problem that has come up that deals with how a dairy termination participant is treated in the case of an involuntary liquidation of the farm after receipt of the DTP payment.

The farmer elected to sell his dairy under the DTP program, and has received his payment. But later his farming operation is liquidated, foreclosed, or forced into bankruptcy. The bank sells the dairy operation, or leases it to another person. Technically, the DTP farmer is in violation of the agreement and must return the funds received.

Does the national office handle that kind of a problem, or is that left to the local office for determination?

Mr. HERTZ. Ultimately, Senator, it would end up here at the national level.

Senator McCLURE. Wouldn't it be better to allow the state and the county to make the determination of whether or not it is a sham, or whether it is really involuntary liquidation?

Mr. HERTZ. Our appeal process provides that the final authority on matters such as this would be vested with the appeal staff here in Washington.

Senator McCLURE. Do we have a national problem, or am I seeing it in Idaho? Is it rather unique, or is it widespread?

Mr. HERTZ. It is quite unique. I think that I know of two other cases in the country similar to the one that you are referring to.

Senator McCLURE. Shouldn't there be an opportunity, if this farmer didn't elect to go out of business, but is forced to, that he shouldn't have to repay?

Mr. HERTZ. I do know, based on one of the cases that we have in the office right now, that we are looking at it. The law provides very clearly that a producer who goes out of the dairy business while participating in the program has promised that he will not produce milk for 5 years, nor will his facility be allowed to be used to produce milk.

In these unique situations where, through a foreclosure, somebody, such as a bank, or even our sister agency, FmHA, ends up with the title and wants to sell the property to a dairyman, it does create a problem.

Senator McCLURE. It is the purchaser that ought to be in here. If you have a farmer who is bankrupt, how are you going to get the money back from him?

Mr. HERTZ. I understand, and we are working to get a solution on that.

AGRICULTURAL CONSERVATION PROGRAM

Senator McClure. I see that the Agricultural Conservation Program funding has been eliminated under the proposed budget. I don't support the move because it is clear to me that the carrot works better than the stick we are trying to use in the sodbuster program. I hope that we will replace those funds.

In the face of that, I would like to know why the Department sent the Idaho ACP funds to the state in four allocations last year, instead of one allocation?

Mr. Hertz. No. 1, Senator McClure, the rescissions that the administration imposed on unspent and unallocated funds caused a delay in allocating some of the funds. No. 2, after the rescission date passed, OMB allocated the funds a quarter at a time. I can tell you now that for the remaining months of 1987, the entire amount of ACP funds has been released by OMB, and they will all be allocated for the rest of this fiscal year.

Senator McClure. If we put money back for next year, do you anticipate the same course of events—the administration will propose a rescission, we will wait for the rescission, and OMB will hold it up again? Or can we look for a smoother administration of that program?

Mr. Hertz. All I can tell you, Senator, is that if I have the funds available, I will try to get the funds apportioned all at one time and get them allocated to the states. I think that we can do a better management job if we get all the funds out there at one time.

COMMODITY CERTIFICATES

Senator McClure. I have one question concerning the assignability of commodity certificates. The prohibition of liens against the assignment of commodity certificates has caused concern within the agricultural lending community because a larger and larger percentage of the borrowers' cash flow is in the form of certificates.

It appears that there is nothing in the 1985 Food Security Act which requires the prohibition of liens against an assignment of commodity certificates. The current regulations seem to be more restrictive than is required by the law.

Does the Department have any plans to change the regulations to allow the assignment of commodity certificates?

Mr. Amstutz. No, we don't.

Senator McClure. Why not?

Mr. Amstutz. Seated before you, Senator, are the two, I think the word is, protagonists on this subject.

Senator McClure. Somebody is glad I asked the question.

Mr. Amstutz. Somebody is glad that you asked the question, and it is not me.

By simply endorsing these certificates, they can be passed on. They are similar to bearer bonds.

Senator McClure. Except that they are not negotiable.

Mr. AMSTUTZ. You mean in the final analysis.

Senator McCLURE. Within the narrow scope.

Mr. AMSTUTZ. Yes; but in a sense they are bearer bonds, and one of the benefits of this program has been the fact that the market for these certificates has been very liquid and very fluid. We, frankly, are concerned about anything we do that would impact negatively on the fluidity and liquidity of that market.

Now people know that there are no liens on them. They are worth their face value to whomever bears them. Because they are so easily transferable, it has been our judgment that this takes care of the lender's problem.

Senator McCLURE. But you don't think that it helps the lender to be able to assign them?

Mr. AMSTUTZ. I understand the problem from the lender's standpoint, but I guess our point is that the lender has access to these in the lender's dealings with the borrower. I understand that the lender would like these things to be assignable.

Senator McCLURE. Can I ask for the other point of view?

Mr. AMSTUTZ. Of course, you can.

Ms. LAWRENCE. Lenders, including Farmers Home, always like to get as much security for any loan as they possibly can get. In the instance of lenders that are regulated by a federal regulatory body, like the FDIC or the Comptroller of the Currency or the FCA, unlike Farmers Home, they are required to get at least sufficient collateral to support the loan that they make.

Therefore, you, and most of the other Senators, as well as the Department, have been strongly lobbied by the lending industry to do this. Farmers Home itself would like to be able to take a lien on these and cannot.

For farmers who have a good relationship with their lender, and vice versa, there is not so much of a problem, because the farmer may very well voluntarily sign them over or give them to the bank to hold. But for the borrower who is on more shakey ground, this becomes a serious problem, and it impacts Farmers Home even more than it impacts banks and PCA's.

Senator McCLURE. Let me ask this question, since I have two points of view in front of me, and, obviously, you have a policy in place. I assume that the discussion goes on. Is that correct?

Mr. AMSTUTZ. Yes; it does go on.

Ms. LAWRENCE. Regularly, sir.

Senator McCLURE. But you don't currently have any plans to make any changes?

Mr. AMSTUTZ. Not currently, but you are absolutely right, Senator, when you say that the law in no way precludes this particular assignment.

Senator McCLURE. I am troubled because I can see both sides of it. My frank assessment would be that you have a more restricted policy than the law requires, and one that I am not certain serves all the certificate holders as well as it might.

DEFICIENCY PAYMENT LIMITATIONS

I have one final question, Mr. Chairman. I am still receiving complaints from the Idaho farmers who are affected by the $50,000 deficiency payment limitation.

Recently, a young farmer in Idaho, whose father's only connection with his operation was that he cosigned his operating loan note. He and his father were eligible for only one $50,000 limitation, even though the father had no attachment to his operation at all, other than cosigning that note. I thought we had stopped that. Am I correct that we had stopped that?

Mr. HERTZ. Yes; we thought that we had stopped that.

Senator McCLURE. What should I do about a specific problem like this one?

Mr. HERTZ. If you would give me the county office that you are referring to, I will do some checking and see if we can't get it squared away.

Senator McCLURE. It shouldn't happen today, should it?

Mr. HERTZ. That is right.

Senator McCLURE. Thank you very much.

Thank you, Mr. Chairman.

Senator BURDICK. Mr. Fosse, I have a question for you. The General Accounting Office is currently conducting investigations in several states relating to the claim payments of reinsured companies with FCIC. Are you familiar with these investigations?

Mr. FOSSE. Yes, sir; I am.

Senator BURDICK. Will you tell the committee what you expect the outcome of these investigations to show and explain what your response to GAO's findings may be?

Mr. FOSSE. We have some idea of what will be shown by the reports, Senator, inasmuch as we have been providing considerable technical support to the investigations. We have some idea of the findings, which we expect to be consistent with the findings of our own compliance division, OIG, and the department.

We fully expect to find some instances of mispayment of claims, and we expect to apply our standard practice, which is to pursue recovery, to pursue the tightening up of practice and procedure by all concerned, of both the reinsured company operations, as well as our own direct operations.

DISASTER ASSISTANCE PROGRAM

Senator BURDICK. I have a finale here for my good friend from North Dakota, Mr. Hertz.

Since last fall, you have been administering a disaster payment program to cover the disasters for 1986. Could you give the committee a brief summary of that program?

Mr. HERTZ. Senator Burdick, the total disaster payments approved total approximately $535 million. There was a $400 million appropriation, which factored out to about a 74-percent payment that we made on those claims.

At this point, except for some individual cases that are in appeal, and some lagging, you might say, due to paperwork in a couple of cases, we have the program pretty well wrapped up. The payments have been made.

Senator BURDICK. I understand that the amount of money for the program was not sufficient to pay all the claims. How much do you need to pay all these claims?

Mr. HERTZ. About $135 million.

Senator BURDICK. Will that be made available?

Mr. HERTZ. At the present time, we do not have that money, sir.

Senator BURDICK. Are you asking for it?

Mr. HERTZ. No.

Senator BURDICK. Are the payments all out?

Mr. HERTZ. Yes, Senator; except for those few that are in an appeal status, and we are still waiting to make judgment on those.

SUBMITTED QUESTIONS

Senator BURDICK. Thank you very much. I have additional questions to be submitted for the record, and they will be coming from Senators Burdick, Bumpers, Kasten, Sasser, and Harkin. We would appreciate it if you could respond to them in writing in an expeditious manner.

[The following questions were not asked at the hearing but were submitted for response for the record:]

AGRICULTURAL STABILIZATION AND CONSERVATION SERVICE

QUESTIONS SUBMITTED BY SENATOR BURDICK

Salaries and Expenses

Question: For fiscal year 1987, you are requesting a supplemental appropriation of $24,000,000 for ASCS salaries and expenses. This request is due to the extremely high workload in the ASCS county offices and you indicate that you are currently working under a deficiency apportionment. If this supplemental appropriation is not provided, when will you need to terminate temporary employees or institute an agency-wide furlough?

Answer: If the supplemental funding is not provided, ASCS will implement an agency-wide furlough of approximately three-weeks duration during the fourth quarter. After considering the alternatives, we feel that a planned furlough at year's end would be less disruptive to the Agency's overall mission than terminating a considerable portion of the existing temporary workforce in the near future.

Question: Is $24,000,000 still an accurate estimate of your needs for this year?

Answer: Based on ASCS administrative costs to date and its projection of workload for the remainder of the year, it is our best estimate that $24 million still reflects funding needs for the remainder of FY 1987.

Question: You show a smaller increase in pay costs and Federal Employees Retirement System (FERS) for fiscal year 1988 ($18,004,000) than for fiscal year 1987 ($18,887,000). Given that the pay cost increase was not in effect for all of fiscal year 1987, please explain why the 1987 figure is larger than the fiscal year 1988 figure.

Answer: The apparent disparity you speak of appears because the question compares a "base" number for FY 1987 to an "increase" number for FY 1988. Actually, both pay costs and FERS are higher in FY 1988 than in FY 1987. Pay costs are higher in FY 1988 because, as you mention, the pay raise was effective for only nine months of FY 1987, and FERS costs are considerably higher in FY 1988 because of the timing for conversion to the new retirement system. As you are aware, employees hired after January 1, 1984, are automatically covered by FERS for an adjusted nine months in FY 1987 and a full year in FY 1988. Civil Service Retirement System (CSRS) "switchers", on the other hand, will have until December 31, 1987 to convert causing the impact in FY 1988 from the CSRS "switchers" to be much greater in FY 1988 than in FY 1987.
By expanding the table shown on page 29-11 of ASCS' Explanatory Notes, you are able to see that the costs related to both pay and FERS are considerably higher in FY 1988 than for FY 1987:

	FY 1987 Estimated	FY 1988 Estimated	Increase
Pay Costs	$8,967,000	$11,956,000	+$2,989,000
FERS	9,920,000	24,935,000	+15,015,000
Total	$18,887,000	$36,891,000	+$18,004,000

Question: Why do you expect reduced commodity loan activity?

Answer: Most of the reduction in the number of loans made can be attributed to feed grains. Feed grain loans are projected to drop from about 5.5 billion bushels in FY 1987 to about 3.2 billion bushels in FY 1988, primarily due to a larger production adjustment program for the 1987 crop. Higher estimated market prices in relation to lower loan rates for the 1987 crop also contribute to the lower number of loans estimated to be made.

The wheat loans estimate also declines from about 775 million bushels in FY 1987 to 580 million bushels in FY 1988 as a result of higher estimated market prices in relation to lower loan rates.

Question: Do generic certificates cause an increase in CCC's administrative costs? If so, can you estimate the amount of the increase?

Answer: Yes, the use of generic certificates does increase administrative costs, both in our county and Kansas City Field Offices. However, at this time it is difficult to assess the total cost associated with the work at the county offices. The administrative cost for redeeming price support loans with certificates in FY 1986 was $7.5 million. In county offices, the use of generic certificates primarily increases workload involved with processing payments and in redeeming the certificates. This work will increase, probably significantly, since there are numerous methods available for the bearer to dispose of the certificates, including cash redemption or as fulfillment of a loan obligation. In our Kansas City Field Offices the use of generic certificates has considerably impacted workload. To process the millions of certificates both issued and redeemed, ASCS has been required to establish new ADP programs, and a new operations group responsible for handling data entry and research. The research process is extremely involved and is necessary for correcting errors and in monitoring, documenting, and verifying the certificates' authenticity once their cycle is complete and they are returned to Kansas City for final disposition. This process is in addition to the already large task required to monitor the certificates and strategically track and match CCC commodity inventories located in warehouses throughout the United States. The Kansas City field office resources have been stretched so thinly by implementation of provisions of the farm bill that it would not be feasible to estimate in a timely manner the increased costs relating to any particular feature.

ASCS

1987 RESCISSIONS

Question: On January 5, the President proposed rescissions totaling $188,522,000 in ASCS programs. I understand that this money has been made available for obligation. Do you expect to obligate all of the these funds in fiscal year 1987? If not, which funds do you expect not to use and for what reason?

Answer: We anticipate that ACP funds will be made available to States and counties for obligation in early April 1987. However, since technical assistance work is often required before contracts with the farmers can be signed, it is possible that all funds may not be obligated in fiscal year 1987.

Under ECP, funds are allocated as disasters occur. Therefore, at the present time, we cannot project what the need for these funds will be during the remainder of fiscal year 1987.

RCWP work plans are submitted in the first quarter of each fiscal year. At present time we do not anticipate obligation of the RCWP funds until these plans are approved.

CONSERVATION RESERVE PROGRAM

Question: Included for the Commodity Credit Corporation expenses are $700,000,000 for the Conservation Reserve Program.

Do you expect to spend all of that money in fiscal year 1987?

Answer: The estimate of $700 million was based on a projected enrollment of 15 million acres for crop years 1986 and 1987. These funds would be used to pay crop years 1986 and 1987 cover costs plus technical assistance.

As of February 1987, approximately 16.8 million acres were enrolled under the CRP for crop years 1986 and 1987. The actual impact of the higher enrollment on our fiscal year 1987 cost estimate of $700 million is unknown at this time. Farmers are just now beginning to actively establish cover on the land.

However, based on an average Federal cost of $57 per acre for cover costs -- which appears reasonable when shortage of seeds and other implements in certain parts of the country are considered -- we project that the majority of cover practices will be completed and payments totaling at least $700 will be required in fiscal year 1987.

1988 CROP ADVANCE DEFICIENCY PAYMENTS

Question: The President's Budget indicates that no advance deficiency payments will be made in 1988. Has this, in fact, been decided or was this merely a proposal?

Answer: At this point in time, it is our assumption that the Administration would not make advance deficiency payments for the 1988 crops.

Question: If we follow the same scenario that was used in 1986, I understand that advance deficiency payments would result in approximately $4.9 billion dollars? Is this correct?

Answer: Yes, we estimate that the amount of advance deficiency payments for the 1988 crop would be $4.878 billion.

Question: By not advancing a portion of deficiency payments, do you save any money in the long run?

Answer: By not advancing a portion of the 1988 crop deficiency payments, some savings in interest would occur. CCC borrows from the U.S. Treasury to finance its payment operations and interest accrues on the outstanding amount borrowed. With no advance deficiency payments, CCC outstanding borrowings would be reduced since a portion of the total deficiency payment--funds borrowed for the advance--would be outstanding for a longer period of time. In addition to interest, administrative costs related to the issuance of advance payments would be saved since one payment would be issued instead of two.

Question: Have you considered the effect that this will have on the farmer's ability to put his crop in?

Answer: One of the considerations that will be included in making the 1988 crop program announcements later this summer will be the farmers' ability to plant his crop.

Question: What do you expect that effect will be?

Answer: Advance deficiency payments provide producers with an opportunity for early cash flow to finance crop seedings. If advance payments are not available it could be difficult for some producers to obtain operating capital to plant crops.

CCC SUPPLEMENTAL

Question: Your estimate for the needs of a supplemental appropriation for the Commodity Credit Corporation in order to reimburse losses is $6.7 billion. Is that figure still accurate?

Answer: Yes, based on current estimates of CCC price support and related activities, it is our best estimate that a supplemental appropriation of $6.7 billion should be sufficient to fund CCC operations for the remainder of fiscal year 1987 and at the same time provide a reasonable operating margin. It is important to recognize that CCC outlays are influenced by highly variable factors, including weather and macroeconomic conditions, and, as such, are not only difficult to predict accurately but are subject to pertinent revisions to meet increased operational demands. A change in any one of these factors could cause CCC funding needs to vary significantly lower or higher.

Question: If that money is not provided in a timely manner, what will be the result?

Answer: Without the $6.7 billion, CCC's available borrowing authority will most likely be exausted in May and CCC would be forced to cease operations. This would mean that all CCC program disbursements including checkwriting and wire transfers for commodity loans, dairy purchases, producer and commercial storage payments, deficiency and diversion payments, and CCC export guarantee claims would be suspended. We believe that it is clearly in the best interest of the farmers whom we serve to avoid the disruptive CCC shutdowns caused by a lack of available funds.

Question: Exactly when do you expect to need the funding?

Answer: Based on the latest cashflow analysis, our best estimate is that CCC's available borrowing authority will be exausted sometime in May.

Question: Do you have a cushion built into this estimate and, if so, of how much?

Answer: Our supplemental request includes $5.2 billion to meet current estimated outlays for the remainder of fiscal year 1987 and $1.5 billion to provide a reasonable operating margin.

DISASTER PAYMENTS

Question: I understand that the amount of money that was made available for this program is not sufficient to cover the entire claims that are eligible. How much money is available for these claims, what is the total amount of claims by State, and how much money would be needed to fund the eligible claims in total?

Answer: Public Law 99-500 which provided for the implementation of the disaster payment program also provided a transfer of $400,000,000 to the Commodity Credit Corporation from funds in the Agricultural Credit Insurance Fund for purposes of making payments.

The total amount of claims from all States was $549,519,088.57 before the $100,000 payment limitation was applied. The total amount needed to pay the eligible claims, after application of the payment limitation, is $534,533,617.20 and is broken out by State in the accompanying table. However, some additional funds may be needed to pay outstanding appeals or underpayments because of errors in computation.

[The information follows:]

JOB NO. 021327001
REPORT ID. MGEAG691

1996 DISASTER PAYMENTS
PAYMENT SUMMARY

STATE NAME	NET NUMBER OF PRODUCERS PROGRAM	NET NUMBER OF PRODUCERS NON PROGRAM	TOTAL PAYMENTS PROGRAM	TOTAL PAYMENTS NON PROGRAM	LIMITATIONS PROGRAM	LIMITATIONS NON PROGRAM	AMOUNTS AFTER LIMIT PROGRAM	AMOUNTS AFTER LIMIT NON PROGRAM
ALABAMA	3,697	593	11,077,394.22	3,327,902.34	.00	.00	11,077,394.22	3,327,902.34
ARKANSAS	7,119	37	24,017,885.39	227,445.93	361,133.36	.00	23,656,752.03	227,445.93
CALIFORNIA	440	0	2,816,188.39	.00	234,895.01	.00	2,581,293.38	.00
COLORADO	82	138	387,402.35	1,446,345.83	.00	66,246.55	387,402.35	1,380,099.28
DELAWARE	144	54	416,296.77	941,456.68	.00	55,430.34	416,296.77	886,026.34
FLORIDA	543	129	2,029,423.97	3,612,939.56	.00	902,252.16	2,029,423.97	2,710,487.40
GEORGIA	7,834	1,393	46,376,842.53	20,455,278.96	286,487.83	2,779,699.87	46,090,354.70	17,675,579.09
IDAHO	479	9	1,012,475.99	40,837.44	.00	.00	1,012,475.99	40,837.44
ILLINOIS	825	20	1,739,404.95	37,894.74	.00	.00	1,739,404.95	37,894.74
IOWA	695	15	1,608,822.36	71,376.72	.00	.00	1,608,822.36	71,376.72
KANSAS	3,422	126	5,473,717.27	298,482.31	.00	.00	5,473,717.27	298,482.31
KENTUCKY	1,610	534	2,609,791.53	1,124,191.01	.00	.00	2,609,791.53	1,124,191.01
LOUISIANA	5,423	72	18,872,585.69	1,030,372.01	55,603.66	69,280.75	18,816,982.03	961,091.26
MAINE	8	52	17,501.38	846,095.38	.00	117,776.90	17,501.38	728,318.48
MARYLAND	577	80	1,882,262.01	808,786.96	.00	91,284.30	1,882,262.01	717,502.66
MICHIGAN	2,289	4,781	7,516,053.32	46,211,372.10	59,214.99	5,080,846.99	7,456,838.33	41,130,525.11
MINNESOTA	1,293	26	3,987,968.76	46,494.99	.00	.00	3,987,968.76	46,494.99
MISSISSIPPI	7,329	57	37,714,711.95	707,410.01	671,812.13	.00	37,042,899.82	707,410.01
MISSOURI	4,659	39	10,396,666.44	230,979.96	.00	.00	10,396,666.44	230,979.96
MONTANA	332	42	880,201.06	544,075.95	.00	.00	880,201.06	544,075.95
NEBRASKA	619	113	1,816,927.63	353,036.23	.00	.00	1,816,927.63	353,036.23
NEW MEXICO	946	70	2,931,208.12	863,054.00	.00	74,220.50	2,931,208.12	788,833.50

STATE NAME	NET NUMBER OF PRODUCERS PROGRAM	NET NUMBER OF PRODUCERS NON PROGRAM	- - - -TOTAL PAYMENTS- - - - PROGRAM	- - - -TOTAL PAYMENTS- - - - NON PROGRAM	- - - - -LIMITATIONS- - - - - PROGRAM	- - - - -LIMITATIONS- - - - - NON PROGRAM	- - -AMOUNTS AFTER LIMIT- - - PROGRAM	- - -AMOUNTS AFTER LIMIT- - - NON PROGRAM
NEW YORK	167	235	362,604.70	3,176,130.41	.00	661,954.92	362,604.70	2,514,175.49
NORTH CAROLINA	5,281	745	12,138,792.35	6,758,626.89	.00	547,143.65	12,138,792.35	6,211,483.24
NORTH DAKOTA	203	0	326,870.45	.00	.00	.00	326,870.45	.00
OHIO	253	7	742,217.33	56,158.16	.00	.00	742,217.33	56,158.16
OKLAHOMA	5,732	613	13,055,570.82	4,058,309.56	.00	431,428.29	13,055,570.82	3,626,881.27
PENNSYLVANIA	105	57	257,786.34	459,347.81	.00	69,714.32	257,786.34	389,633.49
SOUTH CAROLINA	3,855	604	22,456,889.11	6,092,613.72	37,256.25	490,239.09	22,419,632.86	5,602,374.63
SOUTH DAKOTA	5,326	88	8,054,099.17	122,884.56	.00	.00	8,054,099.17	122,884.56
TENNESSEE	2,426	2,148	4,221,785.15	4,463,803.72	49,839.34	1,765.00	4,171,945.81	4,462,038.72
TEXAS	29,491	941	172,398,210.93	7,624,556.99	605,137.84	787,398.03	171,793,073.09	6,837,158.96
UTAH	104	0	202,442.75	.00	.00	.00	202,442.75	.00
VIRGINIA	2,506	1,169	7,080,829.33	5,564,338.31	.00	397,409.00	7,080,829.33	5,166,929.31
WEST VIRGINIA	106	87	375,709.36	110,902.97	.00	.00	375,709.36	110,902.97
WISCONSIN	33	73	54,219.79	363,480.37	.00	.00	54,219.79	363,480.37
WYOMING	34	4	51,337.28	12,655.48	.00	.00	51,337.28	12,655.48
SAIPAN	0	67	.00	68,152.57	.00	.00	.00	68,152.57
UNITED STATES	105,678	15,261	427,361,298.04	122,157,790.53	2,361,380.41	12,624,090.95	424,999,917.63	109,533,699.57

Question: Have all of the payments been made at this point?

Answer: Payments have been made except for appeals, underpayments due to computation errors, and missed applications which were not included in the initial report. Authorization has been given to issue these payments after eligibility is approved by the county ASCS committee. All eligible payments were reduced by 26.1 percent because of the available funds limitation of $400,000,000.

Question: I understand that due to a confluence of circumstances the State of Maine had an area declared as a disaster but the farmers were only allowed a matter of six or seven hours in order to submit an application. USDA had the application for disaster declaration at the end of December, 1986; however, ASCS offices in Maine were notified that they were to begin accepting applications on January 30 for disaster payments while at the same time the deadline for these applications was January 30.

Does this make sense?

Answer: The county ASCS offices had no authority to approve disaster applications until the county was declared eligible by means of an emergency declaration. Such a declaration could not be made until a request was received from the Governor. Governor Brennan made his request in a letter dated January 6. The average processing time for these requests is two weeks. The counties in Maine received an emergency declaration on January 29.

Question: What is the estimated cost of funding eligible applications in the State of Maine if an adequate application time had been provided?

Answer: After the $100,000 payment limitation was applied, eligible applications totaling $845,819.86 were submitted in Maine. After applying the proration factor of 26.1 percent, a total amount of $625,060.88 was issued to eligible Maine producers. It is estimated that additional applications in the amount of $850,000 would have been accepted if there had been sufficient time to take applications.

Question: Are there other situations similar to the State of Maine?

Answer: Yes, 80 counties were declared eligible for emergency loans on January 29 and 30 in five States.

Question: What disasters have occurred so far in fiscal year 1987?

Answer: Excessive moisture has been a serious problem in several Midwestern and Great Plain States in fiscal year 1987 and has caused damage to both crops and livestock.

Question: What losses have occurred as a result of these disasters?

Answer: If the disaster affected the 1986 crops and the producers were eligible, disaster payments were issued or are being processed. The authorized disaster payments only apply to the 1986 crops and do not cover the producers who were prevented from planting winter wheat for harvest in 1987 nor do they cover losses for disasters which occurred in calendar year 1987.

Question: Please provide the information by state and by type of disaster.

Answer: No breakdown of damages by type of disaster is available on a State-by-State basis. However, as I already mentioned, a table showing disaster claims by State is being provided.

EXPORT CREDIT

Question: The budget request for fiscal year 1988 includes changes in the export credit levels. For the short-term export credit, the Administration proposes a ceiling of $3 billion which is a sharp reduction from the floor of $5 billion in credit guarantees for fiscal year 1987. In addition, for the intermediate export credit guarantees, the Administration proposes a ceiling of $500,000,000, as opposed to a floor of $500,000,000 which was enacted for fiscal year 1987. In view of this Administration's and the Secretary of Agriculture's statements that it will give high priority to exporting our farmers' production, why are you sharply reducing these export credit guarantee programs?

Answer: The high priority assigned to export programs has not changed. The proposed reduction in the authorized level of GSM-102 short-term credit guarantees from $5 billion to $3 billion reflects our desire to reduce the budget program level while maintaining our emphasis on exporting agricultural commodities and products. In the past two fiscal years we have announced the availability of over $4 billion annually in short-term credit guarantees to about 25 countries.

In each of the two years the value of exports registered under this program totaled approximately $2.5 billion. Assuming credit guarantees approved continue near previous levels, the $3 billion authorization should be sufficient.

For the GSM-103 intermediate credit program, we are proposing $500 million which is consistent with the level authorized in the Food Security Act of 1985.

Question: Do you have anything to take the place of these programs and to cover for the reductions you propose?

Answer: We believe the proposed fiscal year 1988 levels for GSM-102 and GSM-103 are sufficient to cover the needs of importing countries for short-term and intermediate credit guarantees. We do not anticipate that demand for these programs will exceed our proposed program levels.

SUGAR PROGRAM

Question: In order to maintain the domestic price on sugar, the United States imposes quotas on imported sugar. I understand that tons of sugar are coming into this country by being blended or mixed with other products. Are you aware of this situation? How many tons of sugar come in annually by this method? Is this legal? What would you recommend be done to bring this sugar under the import quotas?

Answer: We are fully aware of this situation. So-called "blended sugars" are subject to the emergency import quotas established by Presidential Proclamation No. 5294, as amended by Presidential Proclamation No. 5340 of May 17, 1985. These quotas are applicable to dry mixture sugar-containing products, originally classified under items 183.05, 183.01 and 156.45 of the Tariff Schedules of the United States, which have a sugar content in excess of 10 percent by weight. Thus, the importation of the type of products you are inquiring about is perfectly legal and subject to import restrictions.

The quotas cover a wide spectrum of products, making it difficult to estimate how much sugar enters under these quotas. However, the commercial weight of products which can be entered under the quotas cannot in aggregate exceed 94,000 short tons per fiscal year. If the average sugar content is 50 percent, this would imply 47,000 short tons of sugar entering under these quotas.

There are, of course, numerous other processed and semi-processed sugar-containing products which are not subject to import quotas. Imports of these products, such as chocolates and candies, have increased dramatically over the past few years. We are reviewing the situation to determine whether such imports are disrupting our domestic sugar price support operations. However, it should be noted that the reason we are experiencing large increases in imports of sugar-containing products is that the existing legislation supports U.S. prices at levels much higher than the world price. This gives overseas manufacturers of these products a competitive advantage over domestic manufacturers. The end result is that the domestic manufacturer either goes out of business or relocates overseas, causing a permanent loss in U.S. employment and infrastructure.

The solution to this problem is not in the application of import quotas to the thousands and thousands of products which contain sugar. The problem can only be overcome by eliminating the differential between world and domestic prices, something which the Administration's proposed legislation would go a long way towards accomplishing.

Question: You have just submitted proposed legislation which would change the sugar program. You would propose that you pay farmers up to approximately $1.1 billion over the next four years to stop growing sugarbeets and sugarcane. Isn't it true that the current sugar program is not costing the Government any money?

Answer: While it is true that the current program is designed to operate at no budget expense to the Treasury, the program does impose a heavy cost on U.S. consumers and industrial users of sugar. To maintain a no-net-cost program, sugar prices must be kept at a level far above the world price. Sugar users in FY 1987 will pay an estimated $3 billion in additional costs of sugar and high fructose corn syrup (HFCS) because of the program. There has also been a permanent loss of employment and infrastructure in domestic sugar-using/food processing industries as they move overseas to take advantage of world price sugar. The domestic cane sugar refining industry has also suffered from decreased capacity and resulting unemployment as sugar consumption decreases and high fructose corn syrup (HFCS) consumption increases. Because HFCS can undercut the artificially high sugar price maintained by the current sugar program, HCFS has made inroads in domestic sugar consumption at the expense of raw cane sugar imports.

Question: Part and parcel of this proposal is the idea that farmers should turn to other crops. This is similar to the 92/50 provision that was originally included in the Farm Bill and then was immediately changed because of the other crops that might be grown on former program acres. What crops would you suggest that these sugar farmers raise instead of beets and cane?

Answer: It is important to remember that the purpose of the proposed 4 years of producer payments is not to pay producers to stop growing sugarcane and sugar beets but to ease the transition to a lower loan rate. Cane and beet growers should make decisions about acreage allocation and program participation based on a comparison of income streams from sugar versus alternative crops. A producer who discontinues growing sugarcane or sugar beets and decides to plant an alternative crop should make that planting decision based on his experience, knowledge and perceptions of the markets.

Question: If this legislation were enacted, do you have any reason to believe that the products containing sugar would go down in price?

Answer: The price effects of the legislation would largely depend on the sugar content of the product involved. There would probably be no tangible effects on those products that contain very little sugar. However, in products containing larger amounts of sugar, a moderation in upward price movement can be expected. Given the competitive nature and conditions of the sugar-using food processing industries, lower sugar prices should translate into price moderations for products with significant sugar content.

Question: Have other products, such as bread, gone down in price when the price of wheat has gone down?

Answer: The wheat content in bread contributes a very small percentage to the price of a loaf of bread--about 8-10 percent. Prices for bread in the past 2 years have been fairly stable and any small increases can be attributed to factors such as packaging, marketing and distribution. Also, the price of wheat changes when processed into flour because wheat cannot be directly used in a product the way sugar can.

HONEY PROGRAM

Question: The Honey Loan Program is the only farm program that has a cap on the amount of the CCC loan. Is that correct?

Answer: The honey industry is presently the only industry that has an outstanding loan limitation. The FY 1987 Omnibus Continuing Resolution placed a cap of $250,000 on gains realized by honey producers as a condition for paying back their commodity loans at less than the original loan level and also limited to $250,000 the amount of outstanding honey loans permitted a producer less the gains realized through a lower loan repayment level.

Question: Have you implemented that provision and what have been the budgetary savings so far?

Answer: The provision for the outstanding loan limitation is effective for the 1987 honey crop. This crop will begin to go under loan no earlier than April 1, 1987. Therefore, budgetary savings data is not yet available.

Question: What has been the effect of that cap on honey loans in terms of supply and production of honey?

Answer: The provision for the outstanding loan limitation will be implemented when the 1987 crop is eligible for price support loans--no earlier than April 1, 1987. Therefore, to date, the cap has had no effect on honey supply and production.

IMPLEMENTATION OF PAYMENT LIMITATION

Question: There has been a great deal of discussion about the way in which farm program payments are targeted and the amount of payments going to individual producers. Much of this discussion has been in reaction to multi-million dollar payments to individual producers. The Administration seems to be considering possible changes to the way in which such payments are targeted. This legislation has now been presented to Congress. Could you briefly summarize the Administration's proposal? What are the budget savings attached to these proposals?

Answer: Our proposal centers mainly around three principles: First, members of farming entities, whether the entity is a corporation, general partnership, or other type of organization, should be treated consistently; Second, a strictly passive investor in a farming operation should not be considered to be "actively engaged in farming" and should not, therefore, be considered as a separate "person" for payment purposes; and finally, payments to an individual or entity should reflect proportionately that individual or entity's interest in the farm operation.

Other recommended revisions are designed to discourage the use of minor children as a means to avoid the limitation; to require entities with similar members to be combined whenever such members have a 50% or more interest in each of the entities; and to limit the type of changes in farming operations that would justify the creation of additional "persons" in order to circumvent the limitation provision.

Our proposal represents a comprehensive plan designed to make the implementation of the maximum payment limitation more effective and equitable by preventing large operators from receiving more than the prescribed maximum limit in farm program payments and by ensuring that the payment limitation is implemented so that primary emphasis is placed on payments being made to actual farmers.

Analysis of the estimated budget savings of these proposals has not yet been completed. They will be made available upon completion.

TARGETING OF FARM PROGRAM BENEFITS

Question: Because of the high level of financial stress facing many farmers, should the Government target more benefits to those farmers experiencing financial difficulties rather than to all farmers, including those that appear to be financially sound?

Answer: Farm programs benefits are structured to provide a price support safety net to producers of various commodities and are made available to each program participant regardless of financial condition. Although farm benefits may provide temporary economic relief they are not designed to and cannot resolve the financial stress being experienced by some producers. These problems would be better addressed through means other than the price support programs.

Question: Do you believe a means test for targeting benefits to farmers experiencing financial stress could be implemented with current ASCS field staff or would additional staff be necessary?

Answer: The present ASCS field staff would probably not be able to adequately and timely handle the workload if a means test was required for program benefit eligibility.

Question: What administrative concerns or other problems do you foresee in implementing any new targeting program?

Answer: The implementation of any new program presents certain problems. First, a learning and understanding phase of the targeting program by ASCS field staff would have to be overcome. Given the current workload situation it would be very difficult for the present ASCS field staff to handle the additional workload of a new targeting program in an adequate and timely manner. Problems now being encountered with the payment limitation/person determinations would likely exist with a targeting program. From an administrative standpoint, one major concern is the large volume of paperwork that would need to be examined to ensure producer compliance with the targeting provisions.

CCC BORROWING AUTHORITY

Question: The budget request for fiscal year 1988 contains an increase in borrowing authority for the Commodity Credit Corporation from $25 billion to $40 billion. Could you please provide a brief summary of the history of the borrowing authority level for the Committee?

Answer: The Corporation's first borrowing authorization of $500 million was established by the Act of March 8, 1938. Authorized increases in total borrowing authority are listed in the table below. Sec. 301 of the Emergency Agricultural Act of 1978, P.L. 95-279, approved May 15, 1978, authorized a maximum borrowing authority of $25 billion, effective only to the extent provided in appropriation acts, which later provided the increased amounts authorized by the May 1978 Act.

Date of Enactment	Authorized Borrowing Authority	Date of Enactment	Authorized Borrowing Authority
3/8/38	$500,000,000	3/20/54	$8,500,000,000
3/4/39	900,000,000	8/31/54	10,000,000,000
8/9/40	1,400,000,000	8/11/55	12,000,000,000
7/1/41	2,650,000,000	8/1/56	14,500,000,000
7/16/43	3,000,000,000	5/15/78	25,000,000,000
4/12/45	4,750,000,000	10/11/78	(5,500,000,000) 1/
6/28/50	6,750,000,000	9/10/82	(5,000,000,000) 2/

1/ Agriculture, Rural Development, and Related Agencies Appropriations Act, Fiscal Year 1979, P.L. 95-448, 92 Stat.1081.

2/ Supplemental Appropriations Act, 1982, P.L. 97-257, 96 Stat. 818.

Question: If the increase in borrowing authority were provided, would you anticipate needing supplemental appropriations during a fiscal year?

Answer: To the extent that sufficient appropriations for CCC losses continue to be made during the regular congressional budget process, notwithstanding any significant unanticipated demands on CCC, it is anticipated that the proposed borrowing authority increase should be sufficient to enable the Administration and Congress to avoid the frequent CCC funding crises and the corresponding need for emergency supplemental appropriations. However, without the permanent, indefinite appropriation authority we are proposing, the first budget estimate would have to be very accurate to avoid possible supplemental appropriations.

CCC NET OUTLAYS

Question: In the estimates that you provide with regard to the costs for the Commodity Credit Corporation for fiscal year 1986 as well as the estimate for fiscal year 1987, you refer to net outlays. How do you calculate net outlays in the commodity loan program? In particular, what is the return to the Government and how does that return differ depending upon whether the loan is paid back, forfeited, or if a marketing loan is in place?

Answer: Net outlays is the difference between gross outlays and receipts. Gross outlays or expenditures represent initial cash outlay by the CCC when the loan is made. These gross outlays are offset by receipts if the loan is repaid. When a loan is repaid, both the loan repayment and interest income are returned to the Corporation as offsetting receipts which reduce the amount of money the Corporation must borrow to continue its operations. The interest income recovers the cost of CCC's borrowings to finance the original loan to the producer. If a loan is forfeited, the Corporation receives no principal or interest income, and is left with an inventory asset which it may sell into the market, as conditions permit, in accordance with law. All sales proceeds are also returned to the Corporation. To the extent these sales receipts do not cover the value of the forfeited loan, a loss to the Corporation may result, which is shown as a loss on inventory operations.

Under the 1985 Act the Secretary of Agriculture has, for the first time, authority to permit commodity loan repayments at less than the original loan principal--the so-called "marketing loan" provision. The marketing loan results in an effective reduction in the loan rate, thereby reducing the likelihood of loan collateral forfeitures and enhancing market competitiveness for U.S. commodities. Payback rates are determined by market conditions and announced by the Secretary. Net outlays for marketing loans represent the difference between the announced loan rate and the repayment rate. Marketing loans result in a loss to the Corporation due to the reduced payback rate; however, by avoiding large forfeitures and the associated high costs of storage and disposition, overall outlays and losses are minimized. Marketing loans are currently in effect for 1986 crop upland cotton, 1986 crop honey, and 1985 and 1986 crop rice.

CROP YIELDS

Question: The Food Security Act of 1985 prescribes the methodology for determining crop yields through the 1990 crop year. Essentially, the Act requires that program yields be calculated as the average of the preceding five years' program yields, except that beginning in 1988, actual documented yield data may be used for any of the preceding five years if the data is available. This method of estimating yield differs from that used by FCIC, even when the same crop land is involved. Is it feasible for ASCS and FCIC to develop a single yield estimation method that will meet the objectives of each agency, thereby ending the practice of assigning two different yields to the same cropland? Also, what method does FCIC use?

Answer: Yes, it would be feasible to develop a single yield estimation method that would meet the objectives of each agency; however, ASCS or FCIC would have to make substantial changes in their method of determining yields.

Historically, with substantial adjustments, ASCS State check yields have been established based on the higher of the 10 year average, 5 year average, or the adjusted 5 year average. Additionally, farmers have been able to "prove" their yields based on the actual production/harvested acreage. In accordance with the Food Security Act of 1985, the 1987 yield is based on the average of the farm program yields for the farm for the 1981 through 1985 crop years, excluding the year in which such yield was the highest and the year in which such yield was the lowest.

FCIC has used a standard 10 year moving average, without an adjustment for weather. When actual production history is not available, FCIC uses a "T-Table"-transitional yield.

Question: What is the estimated impact on administrative cost of having each program participant document actual production for his/her cropland considering that such yields have to be reviewed and approved by USDA personnel?

Answer: In FY 1985, the last full fiscal year in which proven yields were conducted by the agency, the administrative costs associated with performing yields and bases were approximately $678 thousand for cotton and rice and $3.9 million for wheat and feed grains. Since cotton and rice proven yields were mandatory in FY 1985 under the old farm bill, requiring each program participant to document actual production for these two crops would increase costs slightly to approximately $700 thousand. However, since proven yields were optional for the wheat and feed grain programs under the old farm bill, translating actual program participation in 1985 into a mandatory environment would be extremely speculative, since it is difficult to estimate what percentages of the farms actually participated under the old rules. Assuming that each farm participant would require only one year of production evidence to be researched per crop, we project that the associated costs for up to 3 million wheat and feed grain farms could potentially increase to approximately $33 million. This estimate may be conservative, however, and would increase, or decrease, depending upon the number of years of production evidence required to be researched per participant.

Question: Would administrative cost savings accrue from having just a single yield calculated for cropland enrolled in any USDA program rather than the two or more estimates made now for some cropland.

Answer: Yes, administrative cost savings would accrue from having a single yield rather than the two or more estimates made now for some cropland. FCIC could use ASCS's yield as they are currently using in some areas and not apply the T-Table, thereby eliminating the need for further calculation with respect to establishing the yield. However, depending upon the yield that is established, an increase in program payments could offset any cost savings.

CERTIFICATE PROGRAMS

Question: The Food Security Act of 1985 authorized the Secretary of Agriculture to make in-kind payments to farmers and others under price-and income-support program provisions. In-kind payments can be made using (1) generic payment-in-kind (PIK) certificates which may be redeemed for commodities owned by or under loan to the Commodity Credit Corporation (CCC), (2) negotiable warehouse receipts entitling the bearer to specific quantities of commodities; or (3) actual commodities owned by the CCC. As of February 1, 1987, the Secretary has made about $5 billion in payments using generic PIK certificates. Have other authorized forms of in-kind payments been used to make in-kind payments in addition to generic PIK certificates. If not, what advantages do generic certificates offer over the other forms?

Answer: The principal advantage of generic certificates is their flexibility. Generic certificates may be exchanged for more than one kind of commodity either in inventory or under loan in the price support loan programs, are easily traded and promote greater market liquidity. Under the upland cotton program, commodity-specific certificates were issued for the 1986 inventory protection, first handler and loan deficiency payment programs. Although commodity-specific certificates permit similar trading and exchange opportunities to those available with generic certificates, the significant difference is the flexibility. Generic certificates from the start have traded at a premium while commodity-specific certificates have generally been discounted.

Question: What has been the effect of generic PIK certificates in current and projected CCC inventories, the price support loan program, and market prices of price-supported commodities?

Answer: CCC stocks of grain today are nearly double that of a year ago, however, without the certificate program these stocks would have been even higher by approximately 250 million bushels. Without the use of certificates, virtually the entire 1985 crop which was pledged as loan collateral would have been forfeited to CCC, as well as, an additional 250 million bushels listed in CCC's inventory catalog which were acquired by using certificates. Isolated from the marketplace, these stocks would have resulted in additional outlays of up to $500 million for storage and handling of the surplus grains.

With respect to the price support loan program, the loan volume for the 1986 crops is expected to be about one-third higher than for the 1985 crop. Although not all of this increase can be attributed to the certificate program, it likely accounts for the majority. 1986 market prices for wheat and corn, which would probably have been below the price support levels without certificates, are lower due to the certificate program. Corn prices are approximately 25-30 cents per bushel lower with wheat prices down 10-25 cents per bushel.

Question: What is the estimated cost of using generic PIK certificates compared with the cost of using cash for program payments?

Answer: We estimate that outlays associated with the issuance of $8.5 billion of certificates authorized to date for the 1986-88 fiscal years will likely be from neutral to five percent higher than using cash payments. However, this modest additional cost must be weighed against the short-run benefits that are occurring through the use of generic certificates and the long-range implications. These benefits include greater market liquidity, improved market price competitiveness, higher farm income, and an improved farm debt situation. More importantly, certificates are serving as an integral part of our long-range policy towards a more market-oriented farm economy.

Question: Can you explain why PIK certificates have traded at a premium. That is, at prices exceeding their face value? Do these premiums increase the cost of certificates to the Government?

Answer: Generic certificates have traded, from inception, at premiums over face value ranging from 3% to 35%. These premiums, which do not add to the cost of the certificate program, are based on such factors as storage savings, transportation savings, quality differences, the market price versus the posted county price differences and various other marketing strategies and not on the difference between the loan value and the posted county price.

DAIRY TERMINATION PROGRAM

Question: The Food Security Act of 1985 provided for a milk production termination program, beginning April 1986, under which farmers are to be paid to cease milk production and sales for 3-5 years. Producers who wish to participate in the program are to submit bids to ASCS indicating the amount of payment (per hundredweight of milk sales during the established base period) they will accept in order to exit their dairy cows for slaughter or export only; stiff penalties may be imposed on both seller and buyer if the cows are sold for further U.S. milk production. Payments are to be funded in part by an assessment on all dairy farmers' milk sales (40 cents per hundredweight from April 1, 1986 - December 31, 1986 and 25 cents per hundredweight from January 1, 1987 - September 30, 1987) and by CCC funds if necessary. What was the effect of this program on milk production in 1986 and what for 1987 and thereafter?

Answer: Milk production in FY 1986 totaled 145.6 billion pounds--3.9 percent above FY 1985. However, much of that increase, as the following table indicates came during the first half of the fiscal year before the implementation of the Dairy Termination Program. Production in FY 1987 is expected to be 2.5 to 3 percent below 1986. Milk production during the remainder of the DTP and beyond will depend upon the production decisions by dairy farmers who are not participating in the DTP. The table below shows, by calendar quarter, from October 1985 through February 1987 the annual percentage change in milk production.

Calendar Quarter	Year	Milk Production (bil. lbs.)	Percent Change from Year Earlier
October-December	1985	35.424	+9.2
January-March	1986	36.172	+7.5
April-June	1986	38.350	+2.5
July-September	1986	35.610	-2.9
October-December	1986	33.947	-4.2
January*	1987		-3.8
February*	1987		-3.0

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*21 States

Question: Will the program reduce price-support purchases of surplus dairy products? If so, by how much?

Answer: Under the dairy termination program (DTP), CCC purchases of dairy products during the first 5-1/2 months (October 1986-March 20, 1987) of FY 1987 totaled about 3.1 billion pounds milk equivalent, compared with 7.1 billion pounds during the same period a year earlier, a decrease of 4.0 billion pounds. FY 1986 purchases totaled 12.3 billion pounds and FY 1987 purchases are estimated to total 6 to 7 billion pounds.

CCC purchases during the remainder of the DTP and beyond will depend upon the production decisions by dairy farmers who are not participating in the DTP.

Question: Recent genetic and other scientific advances will soon dramatically increase milk production per cow. Will this increase totally offset any reduction brought about by this program?

Answer: Over the years, a steady genetic improvement in dairy cattle as well as improvements in management practices have resulted in increased milk production per cow. This increase in production was largely offset by a decrease in cow numbers leaving total milk production relatively constant. However, in the late '70's, cow numbers leveled off and then began to rise, leading to the large milk surpluses in recent years.

Research is presently being conducted on a bovine growth hormone or bovine somatotropin. The timing for approval of BST by the Food and Drug Administration is uncertain at this time and its rate of adoption by farmers is equally uncertain. A major study is being conducted by the Economic Research Service of USDA addressing this issue. Milk production and CCC price support purchases in the years ahead will depend upon dairy farmers and how they make use of the steady genetic improvement in the dairy herd as well as other improvements in management techniques and scientific advances in their overall decisions.

Question: Will the milk sales assessments cover the amount of payments for participant? If not, how much CCC funds will be required?

Answer: The assessment on all dairy farmers' milk sales--40 cents per hundredweight from April 1, 1986 to December 31, 1986 and 25 cents per hundredweight from January 1, 1987 to September 30, 1987 — will return to CCC about $650-$700 million. This is roughly 38 percent of the $1.8 billion buy-out payment to program participants. CCC funding will be required for the balance of about $1.1 billion.

DAIRY PROGRAM

Question: Under the Dairy Program, the price of milk is supported through the purchase of milk and milk products. Presumably, only the surplus milk and milk products are purchased. How does ASCS determine that the products purchased are actually in surplus and would not have been purchased at or near the support price?

Answer: There are no special procedures to assure that dairy products offered to CCC for purchases under the milk price support program are actually surplus. It is assumed that the dairy industry will meet the needs of commercial customers before dairy products are sold to CCC. If the industry were to sell less to the commercial users than they actually need, the commercial users would offer to pay more than the CCC announced price support purchase prices in order to obtain the products they need. This would result in less being sold to CCC. Thus, the sales to CCC are dairy products in excess of commercial demand, and are, by definition, surplus.

QUESTIONS SUBMITTED BY SENATOR SASSER

CCC COMMODITY SURPLUSES

Question: Mr. Hertz, the cost of storing vast Commodity Credit Corporation (CCC) surpluses is one of the largest outlays of the Department of Agriculture and now I understand you are requesting a supplemental appropriation of $6.7 billion. But, I see programs such as the Temporary Emergency Food Assistance Program (TEFAP), which provides food assistance to low income and elderly individuals and reduces CCC surpluses, being zero funded.

Programs like TEFAP and P.L. 480 assistance help to reduce CCC surpluses while aiding hungry people around the world. Shouldn't we place more emphasis on programs such as these which serve the dual role of reducing surpluses and providing hunger assistance? Does the Department of Agriculture have effective plans for reducing these tremendous surpluses? When will these reductions occur, will the market take care of the problem?

Answer: The Department certainly agrees that programs serving dual purposes of reducing surpluses and providing hunger assistance should be emphasized. In this regard, many efforts are being made by the Department to improve commodity distribution systems for the Child Nutrition Programs, Nutrition Program for the Elderly, Temporary Emergency Food Assistance Program, and other domestic commodity programs. In the international food assistance area, we are implementing all of the new provisions of the Food Security Act of 1985, such as Food for Progress and the broadened Section 416 overseas donation program, which are resulting in increased volumes of CCC commodities being donated for hunger relief abroad.

With respect to TEFAP, the Department supports its continuation as a viable outlet for Government-owned surplus commodities. The Administration has recommended in the FY 1988 Budget that Federal funding commitments be limited to costs of acquiring, processing, packaging, and delivering surplus commodities to locations specified by States. This substantial Federal commitment, $846 million in FY 1986, supplemented by innovative support from State and local resources, can ensure continued and effective distribution of surplus commodities to those in need.

Annual programming of P.L. 480 commodities has grown substantially under this Administration. The President's Budget for FY 1988 requests funding which will provide for the shipment of approximately 7.8 million metric tons of commodities. This level will be well above the volume of commodities made available through the program in the late 1970's and early 1980's, when programming averaged 6.0 million metric tons annually. Overseas commodity donations from CCC inventory under Section 416 authority are also increasing. During FY 1985, 147,000 metric tons of CCC commodities were approved for donation overseas. This level grew to 335,000 metric tons in FY 1986, and thus far in FY 1987 program approvals for approximately 500,000 metric tons have been made.

It must be recognized, however, that in the long run programs providing for domestic and foreign commodity donations will not be efficient solutions to the problem of surpluses. Our surpluses are simply too large to be disposed of through these programs. Rather, we believe that reducing incentives to overproduce and moving existing stocks into commercial channels are better answers to the surplus problem. Accordingly, price support levels have been reduced and generic certificates have been issued in order to help restore our competitiveness in international markets. We have proposed that the link between planting and deficiency payments be eliminated so that farmers will not be forced to plant to receive income support. This is our approach to reducing commodity surpluses, and although this approach takes time, we believe this course will provide a lasting solution to the problem.

RURAL CLEAN WATER

Question: Mr. Hertz, the Administration has proposed the elimination of the Rural Clean Water Program. As you know, this program assists in cleaning up nonpoint water pollution problems in rural areas such as my State of Tennessee.

In fiscal year 1986, Tennessee received $468,000 in assistance, much of which went to efforts to clean up Reelfoot Lake. Now, we have a pollution problem in Kentucky Lake as well. Elimination of these programs could hamper the continuation of these clean-up projects.

The Administration first vetoed the Clean Water Bill and now has asked for further reductions in rural clean water programs.

What type of message is this to those people across America who are deprived of clean and adequate water every day?

Answer: The need for adequate clean water is a great concern to us all. However, it is my understanding that the rescission proposal submitted by the administration would not adversely affect the implementation of the RCWP in any way, since sufficient funds are available to complete the 21 projects that were approved under the experimental program.

While the RCWP funds that were proposed for rescission can now be used to expand existing projects or to begin new ones, these goals, as you indicated, can now be accomplished under the Clean Water Act through grants to States, with coordinated direction provided by EPA. Presumably the greatly expanded effort under the new Act will be a more effective method of addressing nonpoint source pollution problems in the future.

EMERGENCY CONSERVATION PROGRAM

Question: Mr. Hertz, the Administration has proposed elimination of the Emergency Conservation Program in this budget. Many farmers could not make it through a disaster without the assistance this program provides, especially in these troubled times.

We cannot predict the occurrence or the impact of a natural disaster, nor can we assume that all farmers will be able to sign up for crop insurance. What other programs would be available for farmers in the case of a natural disaster if the Emergency Conservation Program were eliminated?

Answer: Farmers would continue to receive assistance under the ECP until the funds currently available are exhausted. At that time, farmers whose lands are too extensively damaged to rehabilitate with their own resources would have to seek assistance from State or private sources. Another option would be to amend the FCIC authorizing legislation to allow coverage for damaged cropland to farmers who wished to apply.

QUESTIONS SUBMITTED BY SENATOR KASTEN

PROPOSED 0/92 PROGRAM

Question: There has been a lot of talk in Congress about the so-called 0-92 option — that is, allowing farmers not to plant any of their base acreage and still receive 92% of their deficiency payments.

The House voted last week to permit this for the 1987 crop of wheat. Some Senators are considering expanding this to include corn and other program crops.

Does the Department have a position on making all producers of program crops eligible for 0-92 for the 1987 crop year?

Answer: Conceptually, we support the 0-92 program, but we feel that it is too late to implement such a program for the 1987 crop year.

Question: Also, bearing in mind that it is very late in the year to be making changes in the program, can you give us an estimate of the savings to the CCC if Congress enacted 0-92?

Answer: As you pointed out in your question, it is getting too late to implement a 0/92 program for the 1987 crops. However, if the 0/92 program were implemented in 1987 it is estimated that idled acreage under such a program would range from one to three million acres with an associated savings of $150 to $250 million.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

BIENNIAL BUDGET CYCLE

Question: Calls for budget reform are increasingly heard as budget deadlines are too often missed, important budget decissions are delayed, appropriation bills and other direct spending legislation are held up in committee, and omnibus spending bills take the place of timely and orderly consideration of individual bills. One procedural reform that is being considered is the two-year budget cylce where budget and appropriations matters would be considered in the first year, and authorizations and oversight would be undertaken in the second year. Would your agency favor a biennial budget process? What benefits would your agency achieve in a two-year appropriations cycle?

Answer: ASCS would strongly favor this type of reform, but the objectives of the concept could only be partially achieved for CCC. Since CCC program outlays are so volatile and dependent on many factors, including weather and growing conditions, supply and demand and the general health of the farm economy, we feel the CCC budget would be only marginally conducive to the biennial budget concept. Due to the close relationship of the ASCS salaries and expenses account to CCC program workload volumes, we feel that the S&E account would also not be wholly conducive to the concept.

Overall, ASCS would realize several advantages from this proposal. Primarily it would reduce the volume of paperwork and a significant amount of repetitious and tedious work activities involved in the budget formulation, presentation and justification process. Such as, preparation of Agency Estimates; Department Estimates and President's Budget; Explanatory Notes; Testimony; and Questions and Answers prepared for Congressional Hearings. The time saved in a biennial budget environment would allow for more time to be concentrated on the budget execution and review process; providing staff and management officials valuable time needed to better evaluate programs; analyze program accomplishments; and ultimately be in a better position to recommend program changes for better utilization of resources.

Question: Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer: About 75 percent of the work involved in the ASCS/CCC/PL-480 budgets is repetitious, particularly during years when no major changes to farm program legislation are enacted. For conservation programs this work is straightforward and relatively stable from year to year, except that ECP and Dairy Indemnity workload vary from year to year since they are emergency type programs. For CCC and S&E, however, while their budget preparation requirements are voluminous, the actual work involved is not repetitious except in a format sense. Each years' estimate for the CCC is dependent on market conditions, supply and demand, program announcements and the general health of the farm economy. The S&E estimate is dependent on the resultant workload generated largely by the CCC programs. A large amount of complicated and tedious analysis is required for each of these factors, with the estimates being closely tied and scrutinized to the general program provisions included in farm bill legislation.

Question: What difficulties can you foresee in preparing and submitting a two-year budget to the Congress?

Answer: The greatest problem will be in the CCC Budget, because the basic assumptions used in developing the budget can change so drastically between the time the budget is developed and the time the budget is actually carried out. Changes occur due to various reasons, including changes in legislation, supply/demand variances, discretionary program announcements, the farm economy, etc. Since these assumptions could change considerably over a two-year cycle the variance in appropriation needs for CCC reimbursement of losses (assuming current practices) to fund the corporation's operations could be significant. This funding problem could be alleviated, permitting the biennial concept to work reasonably well for the CCC, if Congress were to approve the Administration's proposal to increase the CCC line of credit with the Treasury from $25 billion to $40 billion, and to approve a proposal to provide the corporation with permanent indefinite borrowing authority. With the increased line of credit and the ability to go directly to Treasury, CCC would be able to meet fluctuations in its funding needs by borrowing funds from the Treasury on demand, rather than first being required to depend on supplemental requests to be enacted by the Congress.

For the S&E account, ASCS administrative activity correlates directly to CCC's operations, and can therefore vary dramatically between the time the initial budget is developed and the time it is carried out, as FY 1986's experience indicates. Given the priority nature of servicing farm communities in a timely and efficient manner, ASCS would find it extremely difficult to accurately project funding needs in a two-year environment. As a matter of course, we would continue to see the need for additional supplemental funding actions during the cycle in order to accommodate the historically fluctuating workload. Since ASCS S&E funds are largely provided through CCC transfers, one idea would be to provide ASCS current indefinite transfer authority (subject to certain caveats and limits), but only to the extent that appropriations provided are not sufficient to cover workload.

For conservation programs, the only problems we foresee deal with the Emergency Conservation Program and the Dairy Indemnity Program. Since these programs are emergency related, it would be difficult to predict these program's needs with a great degree of accuracy, but a two-year cycle would not be materially different from current supplemental funding arrangements.

Question: Would you expect to realize any budget savings if you could plan your agency budget on a two-year basis? If so, could you estimate how much?

Answer: We think any time savings resulting from approval of this reform would be redirected to the budget execution and program review process. We would therefore expect to see little reduction in the staff effort devoted to the budget function in general, because some updating in the second year would undoubtedly be required by either OMB or the Congress. However, if this did not actually occur, then every attempt would be made, through attrition, to match workload and staffing.

Question: If you oppose the biennial budget concept, please give this subcommittee your reasons why.

Answer: As stated earlier, ASCS strongly favors the concept in general, but the tenuous position the CCC and the S&E account would be in should be recognized.

FEDERAL CROP INSURANCE CORPORATION

QUESTIONS SUBMITTED BY SENATOR BURDICK

GAO FINANCIAL AUDIT OF FCIC

Question: In a General Accounting Office report issued in September, 1986, the Comptroller General made the following statement:

> We found that the Corporation does not verify premium and loss information submitted by reinsurance companies who sell and service multiperil crop insurance policies under agreements with it. Therefore, the Corporation has no assurance that financial information reported to them by the reinsurance companies is accurate. The Corporation uses this information as the basis for making payments to the reinsurance companies and for reporting reinsurance income, losses, and expenses on its financial statements.

Has FCIC improved its oversight of the loss adjustment activities of reinsured companies since this GAO report was issued?

Answer: GAO is in error. Every policy written by a reinsured company has since the beginning in 1981 been subjected to a computerized audit to verify, among others, the following:

a. that the crop and location are eligible;
b. that the correct rate for crop, coverage, practice and location has been used;
c. that the guarantee, liability, premium and loss, if any, has been correctly calculated; and
d. that the expenses claimed are calculated correctly.

In addition, routine reviews are conducted to verify that company loss adjustment work conforms with prescribed procedure.

FCIC has improved its oversight of loss adjustment activities and continues to intensify the effort.

LOSS ADJUSTMENT PRACTICES OF REINSURED COMPANIES

Question: Are loss adjustment practices of reinsured companies conforming with FCIC procedures?

Answer: FCIC approves all loss adjustment procedures, adjusting manuals, and forms used by the reinsured companies.

ADMINISTRATION AND COMPLIANCE

Question: The fiscal year 1988 budget calls for a $5.6 million increase for program administration and compliance work. How much of an increase will there be for each of these two areas?

Answer: Of the total $5.6 million increase in the fiscal year 1988 Budget, $182,000 is directly related to compliance activities bringing the total needed for compliance to $2.6 million for fiscal year 1988. The remainder of this increase would fall under program administration, with an increase of $1.9 million for pay costs and the Federal Employees Retirement System; and a net increase of $5.9 million for non-discretionary program changes (including reinsurance administrative, agents' commissions, Actual Production History, and loss adjustment). These increases are offset by decreases due to reduced staff-years, resulting in a net increase of $5.6 million.

Question: Why will they be increased?

Answer: The $5.6 million increase is needed for increased pay cost and Federal Employees Retirement System as well as an increase to cover expenses related to an increase in the estimated program level from $500 million in premium in fiscal year 1987 to $513 million in fiscal year 1988.

GAO REVIEW OF CLAIMS PAYMENTS

Question: The General Accounting Office is currently conducting investigations in several states relating to the claims payments of reinsured companies contracting with FCIC. Are you familiar with these investigations?

Answer: We are aware of the GAO investigations having often provided technical assistance to their people.

OUTCOME OF GAO INVESTIGATIONS

Question: Will you tell the committee what you expect the outcome of these investigations to show and explain what your response to GAO's findings may be?

Answer: We expect the investigation to report findings consistent with our own compliance review findings and those also of USDA OIG. That there may be discrepancies in what producers should have been paid is not new. Our response to GAO findings will be consistent with existing practice which is as follows:

a. The company is afforded an opportunity to present its follow-up determinations (reviewers and investigators are not always correct).
b. Where there is a procedural lapse, remedial measures will be required and monitored.
c. If indeed overpayments are verified, recoveries will be required.
d. If there is identified a pattern of neglect and inattention to requirements and without redeeming efforts to correct, we can, will, and have suspended operations of a company.

REINSURED COMPANIES AND MASTER MARKETERS

Question: Please explain the reasons for the rapid growth in reinsured companies involvement in marketing crop insurance and how their involvement affects the financial soundness of the FCIC, including consideration of administrative expenses and claims payments.

Answer: The dual delivery system was put in place in 1981. Each producer and each agent has the choice of through which system coverage is obtained. We can only speculate the reasons for the choices which obviously have been made. There is extreme variation in business growth as among the reinsured companies and also as among the master marketers. Some of each have dropped out altogether, some of each have grown dramatically, and some have converted from one to the other.

We do not see that the rapid growth affects the financial soundness of FCIC in any way other than positively. By whomever written, there is an expense associated with conducting business. By using existing industry distribution systems, government avoids the direct cost of duplication. Savings are not fully realized, due to lag in staffing adjustments indicated by the shift in the mix of business. Legitimate claims payments do not differ, since both systems issue the same policy and require the same premium. Even though presently modest, their assumption of risk does reduce FCIC liability.

INCREASED INVOLVEMENT OF REINSURED COMPANIES

Question: How has the increased involvement of reinsured companies affected the ability of the FCIC to manage field operations?

Answer: The ability of FCIC to service policyholders who hold a Federal policy has improved subsequent to the increase of participation by producers with reinsured companies. The rather dramatic change in the mix of business that has occurred since 1982 has left FCIC field operations with more than sufficient personnel to service FCIC paper. Reduction in personnel by attrition has been occuring and nearly 650 field operations staff years have been reduced during this period without affecting the FCIC policyholders' service.

REJECTION OF APPLICATIONS FOR CROP INSURANCE

Question: Do reinsured companies reject any applications for crop insurance? If so, under what circumstances?

Answer: Reinsured companies agree through the reinsurance agreement to offer insurance to all eligible producers within their service area. They are allowed to reject an application or renewal of a crop insurance contract if the producer has not paid their previous year's premium by the sales closing date.

Question: How do these people then receive crop insurance? Through master marketers?

Answer: Producers wishing a crop insurance contract on an eligible commodity may chose either a reinsured company or a master marketer selling Federal paper at their descretion. If the producer is ineligible for nonpayment of a previous year's premium, he will not receive crop insurance from either of the delivery systems.

CERTIFICATION PROCEDURES FOR MASTER MARKETERS

Question: Has the FCIC changed its certification procedures for master marketers over the years?

Answer: The Agent Certification Program, which began in September 1982, has always consisted of three main tests: General Provisions, Actuarial, and Forms Completion, and a crop test for each crop policy. Each crop year the test series is changed to reflect any changes in the crop policies and the APH program. Below is a list of Agent Certification Test Series by crop year:

Crop Year	Series	Number of Crop Tests
1982	A - D	33
1983	D - E	33
1984	G - H	43
1985	I	44
1986	J	44
1987	K	46

Prior to 1985 a minimum of ten agents were needed before a testing session could be scheduled. In 1985, the Corporation allowed testing of less than ten agents upon approval of the Director, Marketing Division.

The Basic Insurance Principles Examination (BIP) was implemented October 1, 1983. Successful completion of this exam was required before certification tests were administered. Below is a list of dates showing the history of that exam:

Date Implemented	10/01/83
Date Extended	12/30/83
Date Cancelled	2/01/84
Date Re-implemented	7/18/85
Date Extended	10/11/85
Date Cancelled	1/31/86

In February 1986, all certification on Tobacco (Dollar Plan) was rescinded, and agents were required to take the exam for Tobacco (Guaranteed Plan). In November 1986, the Corporation required certification on Prevented Planting for the first time. In February 1987, we conditionally certified agents on safflowers.

NUMBER OF MASTER MARKETER AND REINSURED COMPANY CONTRACTS

Question: What is the number of master marketers and reinsured company contracts providing crop insurance for each fiscal year since 1980?

Answer: The information on the number of contracts follows:

	1980	1981	1982	1983	1984	1985	1986	1987
Reinsured	0	17	25	46	49	48	43	42
MMA	0	0	67	63	60	63	50	37

LOSS RATIOS - MASTER MARKETERS AND REINSURED COMPANIES

Question: What has been the loss ratio for master marketers and reinsured companies for each fiscal year since 1980?

Answer: We will provide the information for the record.

FEDERAL CROP INSURANCE CORPORATION
Loss Ratios - Master Marketers and Reinsured Companies
1980 through 1986
(Dollars in thousands)

	Master Marketers (Gov't Paper)			Reinsured Companies		
Year	Premium	Indemnities	Loss Ratio	Premium	Indemnities	Loss Ratio
1980	$157,616	$356,044	2.26	---	---	---
1981	366,361	398,751	1.09	$ 12,808	$ 9,116	.71
1982	320,659	458,460	1.43	78,011	69,697	.89
1983	184,108	404,867	2.20	107,346	182,658	1.70
1984	175,984	257,680	1.46	260,426	380,106	1.46
1985	117,760	209,776	1.78	325,734	470,338	1.44
1986	77,000	132,000	1.71	305,000	460,000	1.51

DOLLAR VALUE & ACREAGE - MASTER MARKETERS & REINSURED COMPANIES

Question: What is the dollar value and amount of acreage covered by master marketers and reinsured companies for each fiscal year since 1980?

Answer: The information is as follows:

FEDERAL CROP INSURANCE CORPORATION
Dollar Value of Coverage and Net Insured Acreage
Master Marketers and Reinsured Companies - 1980 through 1986
(in thousands)

	Master Marketers		Reinsured Companies	
Year	Dollar Value of Coverage (Liability)	Net Insured Acres	Dollar Value of Coverage (Liability)	Net Insured Acres
1980	$3,018,320	26,601	$ ---	---
1981	5,797,132	43,333	185,312	1,587
1982	4,856,758	33,344	1,282,632	9,359
1983	2,778,428	18,050	1,590,900	9,711
1984	2,668,523	17,677	3,998,364	24,595
1985	1,873,621	13,329	5,292,129	35,092
1986 Est.	1,300,000	10,026	5,100,000	38,800

PRIVATIZATION OF CROP INSURANCE

Question: In the fiscal year 1988 budget, the Administration stated that it will introduce legislation to privatize the Federal Crop Insurance program supposedly to eliminate the subsidy presently provided to farmers to include all administrative and operating costs in the premium rates charged farmers over a five-year period. Is it true that under the proposal the Federal government will still be responsible to fund the vast majority of program losses? If so, do you believe it is accurate to refer to the proposals as a privatization of the program?

Answer: It is not true that the legislative proposal calls for continued government funding of excess losses. In fact, the proposal, while specifically retaining a Federal reinsurance capability, also requires that it be premium sustained. Thus the Federal government would maintain its commitment to a strong risk management program, but would require that the program be actuarially sound in both its primary and secondary capital basis.

EFFECT OF PROPOSED LEGISLATION ON PARTICIPATION

Question: I understand that under the proposal, premiums charged to farmers will increase on average from $6.00 to $12.00 per acre. Has FCIC done any analysis to determine how this will affect farmer participation in the program?

Answer: Participation is likely to be affected by a number of factors in addition to rate increases; for example, the elimination of other disaster relief programs and increased producer concern for risk management would have a positive effect on participation. Further, the impact of high rates on participation could be moderated by the fact that these higher rates will be phased in over five years and not just increased all at once. We think we have an understanding of these relationships, but we have not done any empirical studies to measure them. However, even with such a phase-out one would expect the axioms of economics to operate, in this case, the elasticity of demand relative to price. This could be reflected not only in the rate of participation, but also in the choice of coverage options, which operates to some extent under existing subsidy.

Question: The FCIC projects growth of insured acreage in fiscal year 1988 to 60 million acres from 50 million acres in fiscal year 1987. Given your proposal to privatize the present crop insurance program, and the anticipated doubling of premium rates charged to farmers, do you continue to expect such high increases in participation in the next fiscal year?

Answer: It may be that the projected increase of 10 million acres in coverage from 1987 to 1988 is overly optimistic. We have had difficulty in achieving that pace of growth in the past. We are, however, encouraged as to growth levels because of the Congressional action linking the availability of administrative disaster loan assistance to crop insurance coverage, where available, and the general tendency of the Congress to emphasize crop insurance in recent years. Further, the experiences of the 1986 crop year appear to have encouraged private lending institutions to emphasize appropriate risk management to producers seeking operating capital. While we are not able to measure the impact of that activity, we must avoid the potential for falling short of premium and administrative support should our expectations be realized.

Question: Do you expect this level of growth given disaster payments and FCIC's history of overly optimistic increases in acres of coverage?

Answer: We share your concern over the potential impact of the action of the Congress in 1986, providing legislative disaster payments for those affected by the adverse weather conditions experienced last year. The effect of such an action is a continuing concern, however the historical progression of Congressional action insisting on the shift to crop insurance as the Federal risk management program encourages us.

Question: Also, will the increased rates be accompanied by a decrease in the compensation rate paid reinsured cost which is presently 30 percent of premium income?

Answer: Rates of expense reimbursement to reinsured companies and compensation to master marketers would be adjusted to relate appropriately to what would be written premium under the phase-out plan. The objective would be to maintain constant or required dollar levels for the services rendered, recognizing the proposed change in the source of funding.

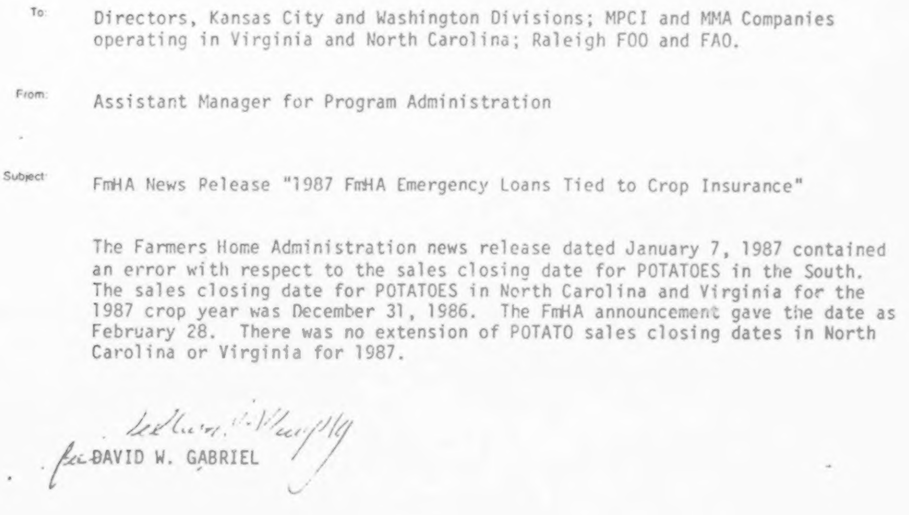
EMERGENCY LOANS

Question: Section 1308 of the Food Security Act of 1985 requires that applicants for emergency loans will be ineligible for financial assistance for crop losses if crop insurance was available for those losses under the FCIC. This provision went into effect on January 1, 1987. Have you made any notice to farmers of the effect of this provision in the counties across the country where crop insurance is available?

Answer: Press releases and notices on Section 1308 of the Food Security Act of 1985 alerted producers of the crop insurance requirements when applying for an emergency loan through FmHA.

[The information follows:]

NOTICE FROM DAVID W. GABRIEL



To: Directors, Kansas City and Washington Divisions; MPCI and MMA Companies operating in Virginia and North Carolina; Raleigh FOO and FAO.

From: Assistant Manager for Program Administration

Subject: FmHA News Release "1987 FmHA Emergency Loans Tied to Crop Insurance"

The Farmers Home Administration news release dated January 7, 1987 contained an error with respect to the sales closing date for POTATOES in the South. The sales closing date for POTATOES in North Carolina and Virginia for the 1987 crop year was December 31, 1986. The FmHA announcement gave the date as February 28. There was no extension of POTATO sales closing dates in North Carolina or Virginia for 1987.

DAVID W. GABRIEL

1987 FMHA EMERGENCY LOANS TIED TO CROP INSURANCE

WASHINGTON, D.C. Jan, 7--Farmers seeking disaster emergency loans from the U.S. Department of Agriculture's Farmers Home Administration for crop losses in 1987 will need to have crop insurance if it is available, FmHA Administrator Vance L. Clark said today.

"All family-size farmers should be aware that a newly-effective provision of the 1985 farm bill prohibits emergency loans for crop losses that could have been insured under multiple-peril crop insurance programs sponsored by the Federal Crop Insurance Corporation," said Clark.

"Therefore, I urge every family-size farmer to seriously consider this new relationship between insurance coverage and emergency-loan eligibility."

Federally-subsidized multiple-peril crop insurance is now available for all wheat, corn, barley, grain sorghum, oats, upland cotton and rice, plus an additional 35 specialty crops in most growing areas. The government subsidy reduces the program costs by about 50 percent, Clark said, making crop insurance a worthwhile option to consider regardless of the newly-required tie-in with emergency loan eligibility.

If a farmer obtains the insurance required, and if the value of his crop loss is still 30 percent or more after the insurance payment, the operation will be eligible for consideration for an emergency loan.

Effective January 1, 1987, the new requirement affects crop planted in 1987, and thus will not affect winter wheat or other winter-seeded crops planted in 1986 and harvested in 1987. Insurance must be multiple-peril, covering most forms of disaster, rather than hail-only.

The closing date for insurance sales on spring-planted crops in most areas of the country is April 15. However, the date is February 28 for potatoes in the South and March 15 for potatoes and peas on the Atlantic Coast; dates for vegetables in the South will vary. Because of these dates and the fact that a prevented-planting endorsement for eligible crops must be elected 45 days prior to sales closing, Clark urged farmers to contact their local insurance agents promptly.

In formation is also available at FCIC field offices and through most county offices of the Agricultural Stabilization and Conservation Service.

REIMBURSEMENT OF BORROWED FUNDS

Question: The fiscal year 1988 budget requests $56.3 million (an increase of $44.6 million over the fiscal year 1987 level), to reimburse the FCIC fund for interest paid on funds borrowed from the Treasury and CCC. Total borrowing from the Treasury and CCC exceeds $500 million. In view of large losses experienced and projected, how does FCIC plan to repay the interest and principal on these loans?

Answer: The Corporation will either pay or accrue interest on the borrowed funds as the interest becomes payable. The Federal Crop Insurance Act permits the Corporation to make such payments and request reimbursement by appropriation in subsequent years.

Through fiscal year 1988, the Corporation has not budgeted to repay any of the principal. Repayment of the borrowings will be made when the Corporation's FCIC Fund reserves are sufficient to allow the Corporation to repay the principal and still have a sufficient amount of capital to continue program operations.

Question: Will premium rates again have to be increased, or do you expect that Congress will be asked to appropriate more funding for reimbursement?

Answer: As indicated above, interest expense will be paid as it becomes due. We will continue to seek appropriation for reimbursement of these expenses.

Premium rates are based on premium/loss experience for each area where coverage is available. Rates are adjusted periodically to reflect changes in experience.

ACTUARIAL SOUNDNESS

Question: Last September, in testimony before the House Agriculture Committee, the General Accounting Office reported that FCIC paid claims amounting to about $2.411 billion during the fiscal year period of 1982-1985. Premium income during the same period totalled about $1.562 billion. For every dollar of premium income earned during this time, FCIC paid out about $1.50 in claims. What was the loss experience of the FCIC in fiscal year 1986?

Answer: The crop year 1986 premium is $382 million, and indemnities are currently estimated at $592 million, for a loss ratio of 1.55.

1987 LOSS EXPERIENCE

Question: Do you have an estimate for fiscal year 1987?

Answer: The Corporation has budgeted for a 1987 loss ratio of 1.46.

Question: Why have the losses been so high?

Answer: FCIC has paid greater indemnities than it has earned in premiums every year since 1980. A series of exceptionally poor years for agricultural production in one or more regions of the country has been a major factor in this situation. Soybeans has lost money in every year since 1980, with the major losses concentrated in the southern and southeastern states. This crop accounts for about 40 percent of accrued losses since 1980. Rates have been increased for this crop, and the privilege of dividing farming operations into two or more insurance units has been rescinded in the states with the worst loss ratios. These actions have not corrected this problem. During the remainder of FY 1987, FCIC plans to examine this crop and area in greater detail to determine the further actions that are needed.

Wheat accounts for about 20 percent of losses accrued since 1980, primarily due to three consecutive years of very poor weather in Montana. Many other states had at least one year of poor experience during this period, with indemnities exceeding premiums for the crop in 1980, 1984, 1985, and 1986. Wheat was one of the exceptions to the general disaster conditions of 1983, when most of the major field crops suffered widespread losses. The total loss in 1983 would have been even greater if the Payment-In-Kind program had not removed many potentially insured acres from production. Other crops, such as cotton, include six loss years in the seven years since 1980. Adverse weather in the high plains area of Texas contributed to these losses, which account for about seven percent of accrued losses. No other crop accounts for as much as five percent of accrued losses, although grain sorghum, peanuts, and tobacco each have between four and five percent of accrued losses.

Under the experimental program, FCIC had authority to take many actions which limited its risk in any year. Sales to new customers sometimes were refused, insurance on some land (river bottoms, for example) was not offered, and coverage levels generally were held at lower levels in much of the country and for many crops than is required by the Act of 1980. Since crop insurance is to serve as the primary risk management tool offered by the Government to producers, FCIC no longer can take some of these actions. Had FCIC been able to limit sales to new insureds in the state of Montana for the 1985 and 1986 crop years, losses for wheat and barley (and total losses) would not have been so large. However, such an action would not be consistent with Congressional intent with regard to the program.

FCIC has raised rates substantially in the past two years. Pricing actions have been taken to increase the insured's cost of the 75 percent coverage level and encourage more business to move to the 65 percent coverage level. This action appears to be having an impact, and a further impact is expected for 1987 since most major crops were affected by this action for 1986. Policy terms and conditions are subject to continuing review to determine any needed revisions to be more consistent with the production practices of a particular producing area. A surcharge for the privilege of dividing insurance units as defined in the policy will be imposed effective with the crops seeded in the fall of 1987. This action will generate additional premium income as well as encourage consolidation of units in some cases. Consolidation is expected to reduce losses.

ACTIONS TAKEN TO ASSURE ACTUARIAL SOUNDNESS

Question: Is it reasonable to expect FCIC programs to be on an actuarially sound basis? If so, what actions is the Corporation currently taking to assure this?

Answer: Yes. As reported by the General Accounting Office on September 23, 1986, before the Subcommittee on Conservation, Credit, and Rural Development of the House Committee of Agriculture, "...FCIC has taken a number of actions that when fully and properly implemented, should enhance the insurance program's actuarial soundness. These actions include developing a new computerized premium rate making model and developing insurance offers based on farmer's actual production histories. It will, however, be several years before these actions are fully implemented."

The testimony of the General Accounting Office further states that "Although the APH (Actual Production History) Program is now applied to nearly all crops, it will take several years for farmers to develop the production records needed to fully implement the program. It will also take several years to fully implement the new rate-making model because (1) the model has to be validated through review and analysis of its application to the six crops, (2) the model has to be revised before it can be applied to other crops, and (3) more and better data has to be accumulated at the county level before the model can be fully implemented, even for the six crops for which it has been used."

Since the testimony by the General Accounting Office which was quoted above, FCIC has implemented a reorganization which places increased emphasis on the actuarial and underwriting functions of the organization. A position of Assistant Manager for Actuarial and Underwriting Services, classified in the Senior Executive Service, has been established and filled. Actuarial and Underwriting Services has been exempted from a general restriction on hiring from outside FCIC as we seek to attract qualified statisticians, mathematicians, and other quantitative skills to staff the new organization. We are beginning recruitment action to seek an actuary who is at least an Associate of the Casualty Actuary Society.

An actuarial data base is under development and should support rate-making activities within the next few weeks. We are in the process of replacing an outdated computer system which has supported our Actuarial and Underwriting functions with modern equipment having substantially improved capacity and capability. Delivery of the first system to our Kansas City offices has been made and the initial applications are being programmed. Orders have been placed for the equipment needed in each of the Field Underwriting Offices. A person has been designated in each of the Field Underwriting Offices to provide statistical support.

We are developing computerized models to assist the field underwriters in performing their underwriting reviews. Our objective is to have the capability to identify those situations which require individual attention rather than forcing each underwriter to carefully examine every case that is presented. We do not have the resources or the time to examine every case in great detail.

The Actual Production History (APH) program will be fully implemented for 1987. Insureds who fail to submit production records for 1986 will be given a yield for 1987 which is equal to 75 percent of the insurance yield used for 1986. The basis on which a loss is claimed in 1986 will be the yield used to compute the guarantee for 1987. The APH plan provides guarantees based on a producer's ability, not on an area average yield as has been the case in the past. APH is self-correcting as far as premium rate is concerned. Increases or decreases in the producer's yield generally translate into opposite moves in the rate. These changes occur automatically and do not depend upon county reviews which are performed at periodic intervals.

Finally, we are examining the potential for using non-traditional information sources in the actuarial process. Insurance experience has played a major role in previous rate-making activities of the Corporation. Reliance on such data as the sole source of information suffers from several drawbacks, including:

--the long time period needed to observe alternative outcomes and estimate the probability of episodic events of very low frequency.

--the need to have a representative amount of insurance in force in a given area in all years.

--the need to have a constant product offering, or, alternatively, a situation in which previously observed experience can be adjusted to reflect changes in the insurance offer.

We are examining the fuller use of climatological data and mathematical modeling to improve our knowledge of the risk process inherent in each crop and geographic area. Additionally, certain remote sensing technologies are being examined for possible use in rate making or underwriting activities.

CROP INSURANCE AS COLLATERAL ON LOANS

Question: What is the degree to which banks and other financial institutions are requiring crop insurance as collateral on loans?

Answer: There is no specific data on the degree to which banks and other financial institutions are requiring crop insurance as collateral on loans.

Question. Is this becoming common in the Federal credit system or among private lenders?

Answer. Reports are that more and more institutions are requiring crop insurance as a condition for certain kinds of loans. This may be especially true in the farm credit system. Farmers seeking disaster emergency loans from the Farmers Home Administration for crop losses in 1987 will need to have crop insurance if it is available. The 1985 farm bill prohibits emergency loans for crop losses that could have been but were not insured under multiple-peril crop insurance programs.

FORECAST OF INDEMNITIES

Question: In your budget proposal, you indicate that the combined efforts of the public and private sector show total premiums amounting to over $500 million and total indemnities at $750 million in fiscal year 1988. Why did the forecast of indemnities jump to 150 percent of premiums in 1988 from the 90 percent used in prior year forecasts?

Answer: The indemnities were increased to 146 percent of premium in order to present more accurate budget information. The Corporation used 146 percent because its historical losses from crop years 1981 through 1985 have averaged 146 percent of premium.

QUESTIONS SUBMITTED BY SENATOR HARKIN

PRIVATIZATION - PROS AND CONS

Question: The FY 1988 budget indicates you intend to "privatize" the FCIC. Please describe this program and what the pros and cons are to both the government and the farmer.

Answer: Under the proposal which has been sent to the Congress in support of the Administration's Fiscal Year 1988 Budget, the privatization of the program represents a shift of all program operations to the private sector insurance companies and delivery systems by fiscal year 1992. The Federal government would retain no direct writing capability, nor any actuarial or underwriting responsibility. The legislative proposal does contemplate a premium sustained reinsurance capability to assure producers and companies of protection against catastrophic losses should the industry find traditional reinsurance markets limited or too costly.

The advantage of the proposal is that it addresses, most specifically, the need to consider the allocation of scarce Federal resources to the administrative task and cost of duplicating functions traditionally performed, and currently available, in the private insurance sector. The issue of federal support to producers for paying the cost of crop insurance as a substitute for disaster assistance is separable from the underwriting issue. Whether or not Congress considers it appropriate to continue, by some device, to assist producers in paying for risk management programs, it is clear that it is not necessary to operate an insurance company to do so. In five years under the authority of the 1980 Crop Insurance Act, the private insurance system has shown its willingness to assert itself in providing coverage. Producers have shifted their purchasing to the risk bearing component of that system, in large measure, for what we believe to be convenience; such as, they are able to obtain insurance from the same agent from whom they purchase other insurance coverages.

The obvious increase in premium to the producer associated with the consolidation of overhead which is consistent with normal accounting for insurance companies' costs may be a problem and construed as a "con" from producer viewpoint. We believe that the increase in actuarial accuracy which we project, the spread of administrative costs over a larger base which we can assume as producers accept the responsibility for their own risk management, and other factors, including the five-year term of the phase-out, will moderate the impact of premium adjustments.

Question: Does the Federal Government retain any liability under this proposal?

Answer: Under the current reinsurance agreements, the Government as reinsurer, is responsible for the bulk of any loss costs above a 1.0 loss ratio. The maximum exposure of a reinsured company, beyond premium income at 1.0, is an additional 15.375% on its retained portion of business written.

Under the proposed legislation, the Government would not have any exposure for loss costs. The reinsurance capability contemplated in the legislation would be, in both loss costs and administrative expenses, entirely premium sustained.

RESPONSIBILITY FOR MAINTAINING A LOSS RATIO

Question: If you maintained a loss ratio of 1.5 - 2.0 who would be responsible for the bulk of these program losses?

Answer: The liability, as noted above, would be entirely premium sustained. No residual liability is contemplated in the proposed legislation. However, as to any given catastrophe year, FCIC as the reinsurer would cover the loss for the year. An annual fee for the reinsurance would be reflected in premium rates and would build a reserve for such losses over time. The loss ratio would be maintained at 1.0 or below.

Question: I noticed in your budget that you anticipate a 1.5 loss ratio. What kind of a loss ratio do you feel ought to be maintained by FCIC?

Answer: We do not necessarily anticipate a 1.5 loss ratio any given year, but based on the last 5-year experience only that it is prudent to budget for the possibility. FCIC ought to realize over time a loss ratio of 1.0 or less.

STATUTORY REQUIREMENT FOR CERTAIN LOSS RATIOS

Question: Is there statutory requirement or expectation that you maintain a certain loss ratio and if so, what is it?

Answer: The Act requires FCIC "to fix adequate premiums for insurance at such rates as the Board deems actuarially sufficient to cover claims for losses on such insurance and to establish as expeditiously as possible, a reasonable reserve against unforeseen losses".

FCIC LOSS RATIOS - 1980 THROUGH 1986

Question: What has been FCIC's loss ratio experience since 1980?

Answer: The following table will provide the combined Federal Crop Insurance Corporation's loss ratios since 1980:

FEDERAL CROP INSURANCE CORPORATION
Loss Ratio Experience - 1980 through 1986

Year	Loss Ratio
1980	2.26
1981	1.08
1982	1.32
1983	2.02
1984	1.46
1985	1.53
1986	1.55

PLANS FOR REDUCING LOSS RATIO TO .90

Question: Do you have any plans for reducing the loss ratio to 0.9 and if so, what are they and what is your proposed time schedule and priority for this effort?

Answer: A new computer system will be used for rate making. This will begin as soon as it is reasonably certain that the major errors in the data base have been eliminated. First priority will be given to a review of rates and rate relationships by farming practice on small geographical areas. Rate adjustment actions in recent years have been limited to the analysis of data at the state level, followed by imposition of across the board adjustments within the state. This probably has created inequities among counties and farming practices. Special attention will be given to soybeans in nine southern and southeastern states and to cotton in Texas during the remainder of FY 1987. These are crops and sections of the country which chronically have poor insurance experience. The total programs for these crops will be examined, not just rates. Policy terms such as the insurance period, loss adjustment procedures, and the structures by which the rates charged to any individual will be reviewed to assure that losses that are being paid are solely the result of unavoidable causes beyond the control of the insured. If this is found to be the case, then rates will be raised again.

Beyond FY 1987, priorities will be dictated by the relative importance of the crop to FCIC's financial position over the longer term.

AVERAGE INSURANCE COST PER ACRE

Question: What has been the average insurance cost per acre for crop insurance from FCIC since 1980?

Answer: We will provide the average insurance cost per acre to the farmer for the record.

FEDERAL CROP INSURANCE CORPORATION
Average Cost Per Acre - 1980 through 1986
(in thousands)

Year	Farmer-Paid Premium Cost	Net Insured Acres	Average Cost Per Acre
1980	$157,616	26,601	$5.92
1981	332,168	44,920	7.39
1982	307,253	42,703	7.20
1983	226,509	27,761	8.16
1984	337,694	42,272	7.99
1985	343,092	48,421	7.09
1986	290,279	48,826	5.95

ELIMINATION OF SUBSIDIES-AVERAGE COST PER ACRE OF CROP INSURANCE

Question: If you eliminated all federal involvement - no administrative subsidy, no premium subsidy, no federal share of program losses - what would be the average cost of crop insurance per acre?

Answer: If all federal subsidies were phased out, the estimated average cost of crop insurance per acre to the farmer would be as follows:

1st year------------$ 8.12
2nd year---------------9.11
3rd year--------------10.24
4th year--------------11.28
5th year--------------12.01

Question: How many farmers would quit taking it?

Answer: It would be logical to assume that significant rate increases would result in a decline in participation. However, participation could be maintained by increased producer concern for risk management and the elimination of alternative disaster assistance including emergency loans and disaster payments.

QUALITY ASSURANCE PROGRAM

Question: Several years ago you initiated, or promised to initiate, a quality assurance (QA) program to insure compliance by reinsured companies with your program requirements. How many people do you have on your QA staff now?

Answer: The quality assurance program initiated by the FCIC is placed under the responsibility of the Compliance Division. The Compliance Division currently is staffed with 28 supervisory, reviewer and clerical support personnel with a ceiling target of 40 to be employed by the end of May 1987. As additional job responsibilities are incurred by this division staffing also may be increased.

REVIEWS BY QUALITY ASSURANCE STAFF

Question: Have they performed any audits or program reviews? Please provide copies of these (summaries only) for the record.

[The information follows:]

REINSURED COMPANY REVIEWS

Case No. KC6RH01 -- Aetna Insurance Company
Rain and Hail Insurance Services, Inc.
Company Operations and Random Loss
Review--Nebr. and Kan.
Date of Review Oct. 29 - Nov. 7, 1986

The review identified $256.00 in overstated premiums, $136.00 in underpaid indemnities and $3,047.00 in overpaid indemnities. The monetary discrepancies resulted from incorrect loss adjustment instructions and production to count determinations. A total of thirteen policies were reviewed.

Case No. DC6BH01 -- Farmers Alliance Mutual Insurance Company
Blakely Crop Hail, Inc.
Company Operations and Loss Review--Kansas
Date of Review Nov. 18 - Dec. 8, 1986

The review identified $294.07 in overstated premiums, $4,623.00 in overstated liability and $3,344.00 in overpaid indemnities. The monetary discrepancies resulted from failure of loss adjusters to exercise proper loss adjustment procedures in finalizing loss claims. A total of ten policies were reviewed.

Case No. DC6EL01 -- E. L. Ross Agency, Inc.
Company Requested Review--Georgia
Date of Review Sept. 9 - Sept. 18, 1986

The review identified program abuses by an agent representative and several producers regarding poor farming practices in planting and control of weeds and grasses. Methods and procedures utilized by the company in these cases were also found to be deficient. Claim payments had not been settled at the time of review. A total of six policies were reviewed.

Case No. DC4TF01 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Loss Adjustment--Arkansas
Date of Review Nov. 18-26, 1985

The review identified $26,876.20 in overstated indemnity and $893.59 in underpaid indemnity. The monetary discrepancies were due to an uninsurable cause of loss, incorrect acreage and area determinations and omitted production to count. A total of two policies were reviewed.

Case No. DC5TF08 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Loss Adjustment - Arkansas
Date of Review Nov. 18-26, 1985

The review identified $10,241.22 in overstated indemnities. The monetary discrepancies resulted from improper replant claims, incorrect practice, area classification and acreage determinations. A total of four policies were reviewed.

Case No. DC6CH04 -- Crop Hail Management General Agency
Special Request Review - Nebraska
Date of Review August 11, 1986

The review indicated a lack of product knowledge and supervision of the sales agent. The insured was not informed and also had questionable farming practices. A mutual consent cancellation was accepted by the company saving a potential $64,408.80 in liability and losses. One policy was reviewed.

Case No. DC6CH01 -- American Security Insurance Company
Crop Hail Management General Agency
Sales Agent Review - Georgia, S. Carolina, N. Carolina
Date of Review Sept. 1986

The review identified improper and unethical sales practices on the part of a sales agent. The agent was not properly licensed. Review questioned $895,000.00 in liablity, $69,376.00 in losses and all premium related expense reimbursement. A total of twenty-eight policies were reviewed.

Case No. DC5CH01 -- American Security Insurance Company
Crop Hail Management General Agency
Whistleblower Complaint - Arkansas
Date of Review Feb. - April 1986

The review identified a questionable indemnity payment of $95,037.00. The monetary discrepancy resulted from impoper determinations in acreage, share, practice and insurable entity by the loss adjuster and questionable farming practices on the part of the insured. One policy was reviewed and several companion contracts paper audited. Request for OIG investigation denied.

Case No. DC5TF01 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Whistleblower Complaint - Mississippi
Date of Review Nov. 1985

The review identified $211,292.00 in overpaid indemnities and $9,309.00 in overstated premium. The monetary discrepancy resulted from improper sales agent practices in reporting of liability and incorrect loss adjustment information concerning acreage, share, entity and planting date determinations. A total of three policies were reviewed. Case submitted to OIG for investigation.

Case No. KC5CH02 -- American Security Insurance Company
Crop Hail Management General Agency
Loss Review - Arkansas
Date of Review Sept. - Oct. 1986

The review identified $123,065.00 in overpaid indemnities and $8,225.72 on overstated premium. The monetary discrepancies resulted from incorrect acreage and practice determinations by loss adjusters. A total of three policies were reviewed.

Case No. KC69001 -- National Farmers Union Property and Casualty Company
Operations and Loss Adjustment Review - Iowa
Date of Review Sept. 15-24, 1986

The review identified $657.00 in an overstated replant payment and questionable premium of $1,538.00. The monetary discrepancy resulted from an improper field inspection after the crop had been destroyed. Questionable premium resulted from late planted acreage included on the acreage report. A total of eight policies were reviewed.

Case No. DC5CH02 -- American Security Insurance Company
Crop Hail Management General Agency
Loss Adjustment Review - Arkansas
Date of Review August 1986

The review identified $252,908.45 in overstated indemnities, $3,544.07 in underreported premiums and another $91,964.53 in highly questionable indemnity. The monetary discrepancies resulted from incorrect determinations in area, practice, acreage, share and production to count by loss adjusters. A total of eleven policies were reviewed. One policy was submitted for OIG investigation.

Case No. DC6TF06 -- Thurston Fire and Casualty Company
Case No. DC6TF08 Southern Crop Insurance General Agency
OIG Requested Review - Mississippi
Date of Review Oct. 15-25, 1986

The reviews identified questionable liability of $395,365.00 with no indemnity payments determined or paid at time of review completion. The monetary discrepancies resulted from poor farming practices on the part of insureds and deficient loss adjustment instructions for policy requirement to replant insured acreage when timely. A total of seventeen policies were reviewed on summer and fall reviews.

Case No. DC5SP01 -- Insurance Company of the Prairie States
Stroud Crop Insurance Company
Whistleblower - Iowa, Illinois and Missouri
Date of Review Sept. 4 - Sept. 14, 1985

The review identified approximately $1.75 million in questionable liability. The liability in question was due to errors and omissions on the part of the sales agent, poor farming practices by the producers, incorrect planting dates and incorrect acturarial determinations. A total of twelve policies were reviewed. A mutual consent cancellation was executed by the company saving potential indemnity of $400,000.00.

Case No. KC54101 -- Old Republic Insurance Companies
Loss Adjustment Review - Arkansas
Date of Review August 1986

The review identified $6,732.51 in overstated indemnities, $295.36 in overreported premium and $769.60 in underreported premium. The monetary discrepancies resulted from incorrect production to count, acreage and practice determinations. A total of two policies were reviewed.

Case No. DC62101 -- Great American Insurance Companies
Company Requested Loss Adj. Review - Oklahoma
Date of Review July - August 1986

The review identified some discrepancies in loss adjustment determinations, but the discrepancies were caught by the company's internal control program review. All discrepancies were resolved by the company and correct indemnity payment was made. A total of one policy was reviewed.

Case No. KC69102 -- National Farmers Union Property
and Casualty Company
E. L. Ross General Agency
Whistleblower - N. Carolina
Date of Review Sept. 8 - Sept. 19, 1986

The review did not disclose any monetary discrepancies. Loss adjustment documents were completed incorrectly, but the company corrected the documents during the review and prior to any loss payment. A total of three policies were reviewed.

Case No. DC5SP01 -- Insurance Company of the Prairie States
Stroud Crop Insurance Company
Congressional Complaint - Texas
Date of Review April - May 1986

The review identified $1,748.43 in underpayments and $221.13 in overpayments on indemnities. The monetary discrepancies resulted from incorrect loss calculations, production to count and quality adjustment factors and lack of product knowledge of sales agent. Upon notification the company corrected all errors. A total of two policies were reviewed.

Case No. KC5SP02 -- Insurance Company of the Prairie States
Stroud Crop Insurance Company
Whistleblower Complaint - Missouri
Date of Review Feb. - March 1986

The review identified $57,276.00 in overstated indemnities. The monetary discrepancies resulted from incorrect use of late planting agreement option by the sales agent and incorrect reporting of planting dates by insureds and incorrect establishment of entities. A total of four policies were reviewed. The case was referred to the OIG for investigation.

Case No. DC6TF09 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Special Request Review of APH
Verifier - Alabama
Date of Review Oct. - Nov. 1986

The review identified several discrepancies on APH review procedures, sales activities of agents including obtaining applications after the sales closing date and incorrect yield information in determining insurance coverages. Three policies obtained after sales closing date identified $108,885.00 in liability and $7,327.00 in premium determined. Three other policies reviewed with excessive liability determined of $2,029.10 and excess premium of $198.79. A total of twelve policies were reviewed.

Case No. KC6TF02 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Loss Adjustment Review - Louisiana
Date of Review Sept. 1986

The review identified $128,471.46 in overstated indemnity and liability, $22,165.56 in overstated premium and $80.81 in underreported premiums. The monetary discrepancies resulted from improper loss adjustment procedures, misrepresented information on loss claims by an agent and producer and a lack of training and oversight by the company of loss adjustment activity. A total of eight policies were reviewed.

Case No. DC6TF10 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
GAO Audit - Oklahoma
Date of Review Oct. - Dec. 1986

The joint review between agencies identified $686,000.00 in overstated indemnties. The monetary discrepancies resulted from conflict of interest, incorrect acreage, planting dates, actuarial and area classification and underreported production to count. A total of nineteen policies were reviewed. The cases were submitted to the OIG for investigation.

Case No. DC6TF07 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Special Request, Loss Adjustment - Mississippi
Date of Review Sept. - Oct. 1986

The review identified $465,624.60 in overstated liability with corresponding premium also in error. The monetary discrepancies resulted from incorrect planting dates, poor farming practices and incorrect appraisal and loss determinations by the company loss adjuster. A total of seven policies were reviewed. Another

$46,678.00 was identified as an overstated indemnity due to incorrect yield history provided by the producer in establishing the unit guarantee. This review was completed on seven policies.

Case No. DC7TF01 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Sales Agent Review - Mississippi
Date of Review Dec. 16, 1986

The review identified approximately 83 active policies for which ten had timely submitted acreage reports on file. Policies that were to be cancelled at insured request were not timely submitted by the agent and remained active in error. Acreage reports for four additional producers were accepted subject to a crop inspection by the company. All others were declared to be zero with no premium or liability established.

Case No. DC7TF02 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Sales Agent Review - Arkansas
Date of Review Jan. 7-8, 1987

The review did not disclose any major discrepancies except that agents were allowed to make claim assignments directly to loss adjusters. Two agents were reviewed. Agents sold policies in Ark. and Miss. but obtained an insurance license for Arkansas only.

Case No. KC6TF01 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Loss Adjustment - Louisiana
Date of Review Aug. - Sept. 1986

The review identified $3,823.47 in overstated indemnities and questioned liability on several policies due to late filed acreage reports with known losses. The monetary discrepancies resulted from incorrect acreage determinations and guarantees of coverage. A total of five policies were reviewed.

Case No. DC5TF03 -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Company Request, Loss Adjustment - Louisiana
Date of Review Jan. 1986

The review identified $263,360.50 in questionable indemnity. The monetary discrepancy resulted from the insured acreage not being inspected and verified by the loss adjuster and the acreage released earlier in the insurance period than reasonable for the crop condition and within policy limits. One policy was reviewed at request of the company.

Case No. DC6TF -- Thurston Fire and Casualty Company
Southern Crop Insurance General Agency
Loss Adjustment Review - Mississippi
Date of Review March - April 1986

The review identified $54,533.95 in questionable indemnity. The monetary discrepancies were due to improper incorporation of seed, poor farming practices on the part of insured, questionable entities, calculation errors and incorrect appraisal methods by company adjusters. A total of seventeen policies were reviewed.

ACCURACY OF LOSS ADJUSTMENT

Question: Have you any indication of the accuracy of loss adjustments by reinsured companies? If so, please provide copies for the record.

Answer: The information on loss adjusment activities were reviewed by the Compliance Division in the approximately 29 reinsured company reviews since 1986 and are included in their findings as previously submitted.

QUESTIONS SUBMITTED BY SENATOR CHILES

NURSERY CONTAINER STOCK PROGRAM

Question. The Florida ornamental horticulture industry is very interested in Federal Crop Insurance. In fact, I understand of the eight states with the ornamental crop insurance available to them, Florida has purchased over one-third of the total premium volume. However, the potential is much greater if FCIC would make changes in the program to better suit Florida's needs. These changes include: flexibility of inventory coverage, entry flexibility and individual peril coverage. I understand FCIC officials have recently visited Florida to discuss these issues. When do you anticipate the FCIC coming up with a product better suited to Florida's needs?

Answer. The nursery container stock program is thus far a most successful venture for FCIC. We are aware of the interest by various producer groups in refinements of the program and, some time ago, met with industry representatives to discuss their interests. We are in the process of evaluating the possibilities for addressing some of the desires expressed. While it is likely that we will be able to respond favorably to interest in some additional crop coverage, other aspects of the protection provided will require substantial review and discussion. We will continue to work with Florida's growers in an effort to meet their needs within the framework of a sound insurance program.

PLANNED CHANGES ON CURRENT COVERAGE - NURSERY STOCK

Question. What changes do you plan on making in the current coverage?

Answer. We do not have any formal changes planned for the current crop year. As noted above, we will continue to work with producers to determine appropriate crop and coverage possibilities for future crop years.

Question. When will these changes take effect?

Answer. Any changes of a substantial nature usually can be put in the hands of sales agents within a year.

COVERAGE FOR TOMATO GROWERS IN NORTH FLORIDA

Question. For some time now, tomato growers in North Florida have tried to get crop insurance coverage. I understand the FCIC has approved a crop insurance program for North Florida. Will this coverage be available for the 1987 tomato crop?

Answer. Fresh market tomato programs are in place in North Florida, new for 1987. This was accomplished pursuant to FCIC Board action authorizing introduction of the program in North Florida, adjacent South Georgia, South Carolina and Pennsylvania, effective with the 1987 crop year.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

BIENNIAL BUDGET CYCLE

Question: Would your department/agency favor a biennial budget process? What benefits would your agency achieve in a two-year appropriation cycle?

Answer. The Federal Crop Insurance Corporation would benefit much from a two-year appropriation cycle. A major benefit resulting from a predictable and stable funding level would be improved program management. The substantial savings in paperwork would allow more time to be spent on program issues rather than with the procedural requirements of the budget process.

Question. Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer. Approximately 95% of the amount appropriated to FCIC is relatively predictable, and could be handled on a two-year basis.

Question. What difficulties can you foresee in preparing and submitting a two-year budget to the Congress?

Answer. The Federal Crop Insurance Corporation already prepares for the President's Budget a 5-year (budget year plus 4 years) estimate in the on-going budget process. Therefore, it appears that the President's Budget could incorporate one additional year without much difficulty.

Question. Would you expect to realize any budget savings if you could plan your agency budget on a two-year basis? If so, could you estimate how much?

Answer. The Corporation would not realize any savings in program funds. However, the time and effort currently spent on procedural requirements of the budget cycle could be better spent on program matters.

Question. If you oppose the biennial concept, please give this subcommittee your reasons why.

Answer. The Corporation is not opposed to the biennial budget cycle, as long as the supplemental appropriation process is available in the event of heavy crop losses.

SUBCOMMITTEE RECESS

Senator BURDICK. This concludes today's hearing. We appreciate your being here today to give us your views on the fiscal year 1988 appropriation for the Department of Agriculture. Our next hearing will be held on Wednesday, March 25, in this same room, begining at 10 a.m. At that time we will hear from representatives of the Rural Electrification Administration. Until then, the subcommittee stands in recess.

[Whereupon, at 3:52 p.m., Monday, March 23, the subcommittee was recessed, to reconvene at 10 a.m., Wednesday, March 25.]

AGRICULTURE, RURAL DEVELOPMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 1988

WEDNESDAY, MARCH 25, 1987

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:10 a.m. in room SD–138, Dirksen Senate Office Building, Hon. Quentin N. Burdick (chairman) presiding.

Present: Senators Burdick, Stennis, Harkin, and Cochran.

DEPARTMENT OF AGRICULTURE

RURAL ELECTRIFICATION ADMINISTRATION

STATEMENTS OF:

KATHLEEN W. LAWRENCE, UNDER SECRETARY DESIGNEE, SMALL COMMUNITY AND RURAL DEVELOPMENT, DEPARTMENT OF AGRICULTURE

HAROLD V. HUNTER, ADMINISTRATOR, RURAL ELECTRIFICATION ADMINISTRATION

ACCOMPANIED BY JACK VAN MARK, DEPUTY ADMINISTRATOR, RURAL ELECTRIFICATION ADMINISTRATION

OPENING REMARKS

Senator BURDICK. The subcommittee will please come to order. Good morning, ladies and gentlemen. Today, we will continue with our hearings on the fiscal year 1988 budget for the Department of Agriculture. Specifically today, we will deal with the Rural Electrification Administration.

Representing that agency, we have Mrs. Kathleen Lawrence, the Under Secretary Designee for Small Community and Rural Development, as well as the Administrator, Mr. Harold Hunter, and also Mr. Dennis Kaplan, representing the USDA Budget Office.

I must say, at the outset, that I am very disappointed with the budget request for the Rural Electrification Administration. We see a proposal by this administration which intends to do away with the Rural Electrification Administration. This agency has served the rural areas so very well over the years, and to have it attacked in this manner will take a lot of evidence to convince me of the necessity of doing so. So I am telling you at the outset that this is going to require an awful lot of explanation.

This proposal is marked by significant decreases in direct loans to electric and telephone borrowers as well as significant reductions in the guaranteed loans. With the legislation that is proposed, the administration would have no guaranteed loans through the Federal Financing Bank. The government guarantee would be reduced from 100 percent to 70 percent. Eventually, all direct loans would be phased out, and the interest rate on current direct loans would be increased immediately from 5 percent to the cost of Treasury borrowing plus one-eighth percent.

This administration has repeatedly tried to kill the REA program, and this year is no different. I will have many questions about this proposal as well as the method to be used.

So members of the panel, I am going to listen with a great deal of interest to your proposal. I will try to maintain an open mind, but you have got an advocate for the REA to contend with here in this chairmanship. So I will give you your day in court, and you can be heard now in any order you wish.

First of all, Senator Stennis, do you have an opening statement?

Senator STENNIS. I will pass for the time being. I am interested in your presentation. We do not have anything down our way that does a better job, that treats the people better for the whole community that we are dealing with today.

Senator BURDICK. North Dakota and Mississippi have known the value of REA, have they not?

Senator STENNIS. Yes; they certainly have.

Senator BURDICK. Now is your chance.

REMARKS OF MS. LAWRENCE

Ms. LAWRENCE. Thank you, Mr. Chairman and Senator Stennis. I am pleased to be here and to introduce the REA budget proposal for fiscal year 1988.

The Rural Electrification Program has been a truly remarkable program. It has nearly achieved the goals established by Congress of bringing quality electric and telephone service to rural America. Through government assistance and guidance supplied by REA, borrowers have developed into strong financial organizations that are well accepted in the private investment community. The current need for government assistance has diminished.

We recognize the strong support Congress has given REA in the past, and we are requesting this year your consideration for a major new initiative. Our proposal recognizes the financial strength of REA's borrowers, their acceptance in the private sector, and the availability of private market funds.

We are proposing to guide the REA program in a new direction which will reduce the electric and telephone borrowers' dependence on the federal government and utilize private-sector financing. This move will assist in balancing the federal budget.

As this committee well remembers, in fiscal years 1986 and 1987, the administration proposed that the REA budget be phased out. In other words, it would phase out all REA loan programs and, in fact, phase out the REA. The Congress did not accept these proposals. I have worked with Secretary Lyng to develop a new plan that we hope will be more favorably received.

We believe the time is here to graduate financially sound borrowers to a private credit market while continuing to provide a source of funds for borrowers who truly need assistance. The cost of borrowing from private sources is now lower than at any other time in recent years.

We want to encourage REA borrowers to use private capital when they are able to obtain their own financing. By promoting borrowers to become independent of government lending, we will reduce the costly REA loan programs, in an effort to balance the budget.

This plan will have no adverse impact on any of the existing portfolio of REA loans and loan guarantees. Prepayments may very well increase but only if borrowers voluntarily choose to refinance their existing loans and their loan guarantees through private sources.

REA will continue to service its existing loans and loan guarantees at no additional cost or loss of benefits to the borrowers. Some loans would be sold on a nonrecourse basis, but such sales are not likely to result in any loss of benefits to borrowers.

The fiscal year 1988 budget proposes a phased move from direct federal involvement to private-sector financing with a 70-percent government guarantee. The guarantee will allow borrowers to obtain capitalization from private sources while substantially reducing any risk.

Direct and Rural Telephone Bank loans would still be available over the next 2 fiscal years. During this transitional period, REA will continue to work with borrowers that are not ready to graduate to private-sector lending. Reliable electric and telephone service to rural communities will continue.

Additionally, the fiscal year 1988 budget proposes increasing the interest rate on direct loans, selling loan assets, continuing to provide for the prepayment of direct and guaranteed loans, and charging a loan-origination fee to fund the administrative expenses of the agency.

The improved economic status of the rural utility industry challenges us to move ahead with less costly programs for the taxpayer. I believe it is a challenge we must accept.

I am pleased to endorse the REA budget proposal and urge your support of the budget request. I would now, with your permission, Mr. Chairman, like to turn over the presentation to the REA Administrator, Harold Hunter, so he can review the proposal in more detail.

ADMINISTRATOR'S REMARKS

Senator BURDICK. Mr. Hunter.

Mr. HUNTER. Mr. Chairman, we appreciate this opportunity to appear before you and this committee to share with you our feelings about a budget which, as Under Secretary Lawrence has mentioned, is very different from budget proposals of the past.

We appreciate the opportunity to hear your comments, to respond to your questions, and share with you the direction and goals that we are pursuing. I would insist these goals are different from the ones that we have brought to you in years past.

To emphasize my desire to have a fresh look given to this, I will ask, with your permission, to stray from the printed remarks. I agree with all parts of it, but in order to emphasize the new initiatives in this budget, I would like to leave the printed statement and allow you to read it. I would like to bring you the same message in a little different manner. Perhaps this will shorten the presentation. I will try to make it brief.

REA, as an agency, and the rural electric and rural telephone industries have a very commendable history. I think they have done great things for rural America. They have done it in the face of real difficulties during these last 50 years.

As a result, 98.9 percent of the farm areas of America now have electric service. Some 96 percent of the people living in rural America have telephone service, not just telephone service but good telephone service.

REA borrowers are prospering. Thank goodness they are prospering, because that means they are building economic strength. I think that is healthy. Electric borrowers' revenues totaled $11.4 billion in 1985. That is an increase of $4.9 billion, or 74 percent more than in 1980, some 7 years ago. They have seen major growth. Net margins amounted to $819 million in 1985, an increase of $464 million, or 131 percent more in 1985 than in 1980, good growth.

In constant dollars, rural Americans pay less for electricity today than they did 35 years ago.

Let's move to the telephone program. I know Senator Stennis has great ties to the telephone industry. He made a great individual effort at the beginning of the telephone program.

Telephone revenues totaled $3.1 billion in 1985. That is an increase of $1.3 billion, or 76.8 percent over 1980. Net margins were almost $488 million, an increase of over 125 percent since 1980. The ratio of net income to investment in plant rose from 2.9 percent in 1980 to 4.6 percent in 1985, an improvement of 59 percent.

In addition, over 90 percent of the subscribers of REA-financed telephone subscribers have private-line, one-party service throughout rural America. I would like to provide data that verifies the statements I have just made. It is done in a very concise, logical manner.

[The information follows:]

Table C-2: Number of Subscribers Served by REA Telephone Borrowers, by Grade of Service**

(Subscribers in Thousands)

	One Party		Two Party		Four Party***		Eight Party*	
Year	Number	Percent	Number	Percent	Number	Percent	Number	Percent
1961	269.6	20.9	124.3	9.6	246.9	19.1	650.7	50.4
1962	306.2	21.6	136.8	9.6	266.1	18.7	710.8	50.1
1963	338.2	22.2	147.6	9.7	278.4	18.3	759.2	49.8
1964	381.2	23.4	165.0	10.2	330.4	20.3	750.0	46.1
1965	428.7	24.8	182.0	10.5	362.7	21.0	752.9	43.7
1966	486.5	26.6	199.2	10.9	418.6	22.9	721.5	39.6
1967	567.1	29.2	211.8	10.9	472.4	24.3	693.0	35.6
1968	680.0	32.9	223.8	10.8	537.8	26.0	625.4	30.3
1969	810.7	37.1	227.5	10.4	560.1	25.7	586.3	26.8
1970	972.3	41.6	227.4	9.8	598.7	25.6	536.1	23.0
1971	1,117.2	46.0	217.0	8.9	642.5	26.5	452.2	18.6
1972	1,298.0	50.4	212.5	8.3	655.1	25.4	409.2	15.9
1973	1,489.9	54.7	200.4	7.3	675.2	24.8	359.5	13.2
1974	1,717.0	58.8	196.9	6.8	695.8	23.8	309.4	10.6
1975	1,909.2	62.7	183.3	6.0	685.2	22.5	267.6	8.8
1976	2,205.2	67.1	166.8	5.1	682.0	20.8	229.2	7.0
1977	2,545.6	70.7	165.2	4.6	668.7	19.1	199.6	5.6
1978	2,861.4	73.8	162.3	4.2	700.2	18.1	153.1	3.9
1979	3,122.8	76.7	153.0	3.7	691.1	17.0	104.8	2.6
1980	3,383.1	79.4	136.1	3.2	669.7	15.7	72.4	1.7
1981	3,582.6	81.9	120.9	2.7	615.6	14.1	54.9	1.3
1982	3,826.7	84.2	103.0	2.3	574.1	12.6	41.8	0.9
1983	3,996.5	86.4	86.9	1.9	519.0	11.2	24.3	0.5
1984	4,193.2	88.3	74.7	1.6	451.0	9.5	28.0	0.6
1985	4,318.2	90.1	62.1	1.3	392.7	8.2	19.2	0.4

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* Includes service stations (switchers) which represent less than 1 percent of the total number of subscribers. Also includes any line with more than Four Party Service, begining in 1984.

** To provide a more accurate representation, data for borrowers with total REA and RTB loans and REA loan guarantee commitments of less than 20 percent of their total assets have been excluded beginning in 1971.

*** Before 1984, Five Party was included with Four Party.

Mr. HUNTER. These gains, in these days when we look at general federal budgets with very serious eyes, we have to recognize have cost the American taxpayer billions of dollars in subsidies in order for these accomplishments to be made.

Not only have the systems changed, as well as the times, but the areas served by REA-financed systems have also changed. Farm areas of yesterday have become urban areas of today. Some are wealthy. Some include large recreational areas and facilities. Some even include resorts. Surveys show that only 13 percent of the people served by REA-financed electric systems are farmers. So that has changed.

REA telephone loans are being made to borrowers who are multimillion-dollar holding companies. Again, for the record I am providing data that establishes this and does it in a knowledgeable way.

[The information follows:]

EXECUTIVE SUMMARY—PROPOSED REA LENDING PROGRAM REFORMS

Administration's Goal

Reduce the excessive costs of the REA credit program and provide a mechanism for borrowers to meet their needs with private resources.

Justification

- The original goal of the REA statute has largely been accomplished. Today 99% of all rural areas now have electrical service and 96% have telephone service.
- The direct subsidy cost (nominal value life-of-loan) to the taxpayer of all REA programs since 1973 is $17.7 billion. The total economic subsidy to all REA borrowers since 1973 is $53.1 billion.
- A significant portion of the subsidized loans are used to provide electric distribution and telephone service in largely urban and suburban areas (e.g. suburbs of Washington, D.C., Atlanta, Minneapolis) and are going to subsidiaries of large telephone holding companies (e.g. CONTEL, ALLTEL). Such borrowers account for only 6.7% of all borrowers yet received 21.4% (or nearly $1.6 billion) of REA lending over 1980-1985 (Tabs I and II). Loans have also been used to provide service to exclusive recreation areas (e.g. Vail, Aspen, Hilton Head Island--Tab III).
- Most REA borrowers are now financially sound and can borrow privately; as a group they reported in excess of $1.3 billion in profit margins in 1985--double the level of 1980 (Tab IV).
- Even though many REA borrowers are subject to State and local taxes, they continue to be exempt from Federal Income Taxes. Certain borrowers are also given preferential access to federally subsidized hydro-power.

Administration Proposed Reforms (Tab V)

- Make available in FY 88 a new and less costly program of REA guarantees of 70% of principal of privately originated loans. This will assure credit assistance for most current borrowers, substantially reduce Federal Budget outlays ($16 billion FY 88-92) and replace all other existing REA lending assistance by FY 90.
- Discontinue all REA assistance to: electric and telephone borrowers serving largely urban/suburban areas; telephone borrowers who are subsidiaries of large holding companies; and borrowers for the purpose of providing service to recreational areas.
- Allow all borrowers to prepay existing REA direct loans at a discount or REA guaranteed FFB or RTB loans without a premium if the borrower agrees never to return for REA assistance.
- Sell a portion of existing loans held by the Revolving Fund and the Rural Telephone Bank and reduce government cost by initiating a loan origination fee to cover REA administrative costs.

[TAB I]

REA Borrowers Who Serve Largely Urban or Suburban Areas

Background

A number of REA borrowers largely serve urban and suburban areas. The U.S. Government defines these areas as Metropolitan Statistical Areas (MSA's) or Consolidated Metropolitan Statistical Areas (CMSA's). MSA's and CMSA's are defined in terms of a central city (or cities) and its corresponding county as well as nearby counties having strong economic and social ties to the central county.

Borrowers Serving Urban/Suburban Areas

Under proposed Administration legislation, any electric distribution borrower or telephone borrower serving more than 20,000 customers and with more than 50 percent of these customers residing within an MSA or CMSA of greater than 100,000 population would be defined as an urban/suburban borrower. Such borrowers would be ineligible for any further REA direct loans, Rural Telephone Bank loans or REA loan guarantees. A review of such borrowers disclosed:

- There are 53 urban/suburban electric distribution borrowers who borrowed from REA between 1980 and 1985. These borrowers represent only 5.7% of all distribution borrowers but accounted for 18.4% (or $872.5 million) of their REA loan approvals (direct and REA guaranteed) between 1980 and 1985 (see Table I-1).

- There are 5 urban/suburban telephone borrowers who borrowed from REA between 1980 and 1985. These borrowers represent .5% of all telephone borrowers but accounted for 4.5% (or $117.7 million) of their REA loan approvals (direct, RTB, and REA guaranteed) between 1980 and 1985 (see Table I-1).

- These borrowers tend to serve customers with high household incomes in rapidly growing urban and suburban areas of cities such as Washington, D.C., Minneapolis and Atlanta (see Chart I-1).

- These borrowers tend to serve cities and large towns, some with population in excess of 20,000 population (see Chart I-1). This clearly goes well beyond the RE Act's restriction of serving rural towns with population 1,500 or less.

TABLE I-1

URBAN/SUBURBAN BORROWERS 1/ WHO HAVE RECEIVED LOAN APPROVALS FROM REA OVER 1980-1985

	Number of Urban/Suburban Borrowers Receiving Loans 1980-1985	Percent of Indicated REA Borrowers	Loan Approvals to Urban/Suburban Borrowers 1980-1985 ($ in millions)	Percent of Loan Approvals to Indicated REA Borrowers 1980-1985
Electric Distribution	53	5.7%	$872.5 2/	18.4%
Telephone	5	.5%	$117.7 3/	4.5%
Total (Electric Distribution and Telephone)	58	3.0	$990.2	13.5%

1/ Defined as a borrower with more than 20,000 customers and with more than 50 percent of these customers residing within an MSA or CMSA of greater than 100,000 population.

2/ Includes direct loans and REA loan guarantees to electric distribution borrowers. Excludes loans to power supply borrowers.

3/ Includes direct loans, Rural Telephone Bank loans, and REA loan guarantees.

CHART I-1
Examples of Urban/Suburban Electric Distribution Borrowers

Borrower (MSA/CMSA)	Number Customers	% of Customers in MSA/CMSA	Largest Towns Served and Estimated % Served	Service Territory Per Capita Income as a % of State Per Capita Income	Reasons for Growth
Alaska 8 Chugach (Anchorage)	58,434	99.48%	Anchorage 229,800 (40-60%)	109%	Growth due to borrower serving Anchorage and surrounding territory.
Georgia 84 Cobb Electric (Atlanta)	64,358	97.00%	Roswell 23,337 (5%) East Marietta 11,900 (25%)	126%	Over the last decade more than 45% of all new housing in the state were in Atlanta and surrounding suburbs; residential growth has been 123% over the last decade.
Louisiana 13 Dixie Electric (Baton Rouge)	50,985	76.35%	Baton Rouge 248,600 (20-40%) Baker 12,865 (10-30%)	93%	Growth primarily due to population expansion in East Baton Rouge County; residential population has expanded by 100% over the last decade.
Maryland 4 Southern Maryland (Washington, D.C.)	72,651	64.83%	St. Charles 13,921 (100%) Lexington Park 10,361 (100%) Waldorf 9,782 (100%)	107%	Outward movement of population from Washington, D.C., has caused a shift from a primarily agricultural-oriented economy to one which is commuter-oriented; residential growth has been 50% over the last decade.
Minnesota 65 Dakota (Minneapolis)	39,504	99.70%	Burnsville 39,700 (30-50%) Apple Valley 21,818 (80-100%) Eagan 20,700 (80-100%)	132%	Most significant growth has been in the residential sector and has occurred in the suburban portions of the residential service area which borders the Twin Cities metropolitan area.
Oklahoma 10 Oklahoma Electric (Oklahoma City)	26,340	78.11%	Norman 77,300 (20-40%) Moore 41,500 (10-20%) Chickasha 17,400 (5-15%)	98%	Growth due to population expansion of Oklahoma City. Former rural parts of service area have been sold for home sites, apartment complexes, and commercial ventures. Residential growth has been 87% over the last decade.

Borrower (MSA/CMSA)	Number Customers	% of Customers in MSA/CMSA	Largest Towns Served and Estimated % Served	Service Territory Per Capita Income as a % of State Per Capita Income	Reasons for Growth
South Carolina 25 Berkeley (Charleston)	39,972	100.00%	Goose Creek 17,811 (50%)	92%	Outgrowth from Charleston, S.C., has resulted in new housing developments, shopping centers, etc. Also, growth from Kiawah and Seabrook Island--both exclusive resort areas.
Tennessee 19 Middle Tennessee (Nashville)	64,838	90.12%	Franklin 13,416 (100%) Brentwood 9,608 (50%) Smyrna 9,442 (100%)	129%	Growth due primarily to its service territory located in the middle of state's principal areas of economic growth in and around Nashville. Residential growth of 54% over last decade.
Virginia 55 Northern Virginia (Washington, D.C.)	45,299	92.82%	Dale City 39,100 (50%) Manassas 15,438 (10%) Manassas Park 6,524 (100%)	111%	Outward movement of population from Washington, D.C., to bedroom communities due to several major highways linking service territory; residential growth has been 75% over last decade.

Urban/Suburban Electric Borrowers Who Have Received Loan Approvals From REA Over 1980-1985

Borrower ID		Borrower Name	MSA or CMSA Location	Percent MSA or CMSA	Customers . (1985)	Loans (80-85) ($ in M)	Cumulative Loans ($ in M)
1	AK8	Chugach	Anchorage	99.48	58434	115.8	115.8
2	AL20	Baldwin County	Mobile	93.91	22510	4.6	120.4
3	AR10	First Electric	Little Rock	54.96	40333	10.1	130.5
4	AR24	Ozarks	Fayetteville	61.65	31618	7.0	137.4
5	CO16	Intermountain	Denver	68.69	41782	21.4	158.9
6	FL14	Clay	Jacksonville	68.52	83767	15.4	174.2
7	FL25	Lee County	Ft.Myers	80.40	91113	42.4	216.6
8	FL29	Talquin	Tallahasse	82.84	29338	19.5	236.1
9	FL33	Withlacoochee River	Tampa	85.55	93946	38.0	274.1
10	GA103	Coweta-Fayette	Atlanta	97.67	23050	11.4	285.5
11	GA35	Walton	Atlanta	95.36	45246	12.1	297.6
12	GA37	Douglas County	Atlanta	97.20	37454	7.6	305.2
13	GA51	Snapping Shoals	Atlanta	98.94	27015	4.4	309.6
14	GA77	Sawnee	Atlanta	85.76	31799	18.1	327.8
15	GA83	Jackson	Athens	65.37	61765	43.2	371.0
16	GA84	Cobb	Atlanta	97.00	67768	33.6	404.6
17	IN60	Morgan County	Indianapolis	58.31	20578	2.5	407.1
18	KY37	Owen County	Cincinnati	50.53	23241	6.4	413.5
19	LA10	Wash. St. Tammany	New Orleans	51.01	26126	19.9	433.4
20	LA13	Dixie	Baton Rouge	76.35	50985	40.5	473.9
21	LA9	South Louisiana	Lafayette	51.85	76009	38.9	512.8
22	MD4	Southern Maryland	Washington	64.83	72651	18.6	531.4
23	MN1	East Central	Minneapolis	57.45	23780	3.5	534.9
24	MN48	Anoka	Minneapolis	99.89	53730	10.3	545.2
25	MN62	Wright-Hennepin	Minneapolis	99.91	20673	4.7	549.9
26	MN65	Dakota	Minneapolis	99.70	39504	13.1	563.0
27	MS28	Coast	Biloxi	72.09	35869	10.9	573.9
28	MS39	Singing River	Pascagoula	73.08	39761	7.1	581.0
29	NC25	Rutherford	Charlotte	66.95	36283	4.2	585.2
30	NC35	Davidson	Greensboro	86.24	24106	8.6	593.7
31	NC39	Union	Charlotte	75.71	21460	3.4	597.1
32	NC43	Jones-Onslow	Jacksonville	61.75	33179	4.9	602.0
33	NC68	Crescent	Greensboro	55.52	29767	4.4	606.4
34	OH65	South Central	Columbus	56.46	52978	12.9	619.3
35	OK10	Oklahoma	Oklahoma City	78.11	26340	15.7	635.0
36	OK25	Verdigris Valley	Tulsa	61.93	20647	14.5	649.6
37	SC14	Aiken	Augusta	67.88	23166	8.3	657.9
38	SC19	Laurens	Greenville	51.60	21724	3.4	661.3
39	SC25	Berkeley	Charleston	100.00	39972	25.9	687.2
40	SC37	Mid-Carolina	Columbia	89.10	27171	6.7	693.9
41	SC38	Blue Ridge	Greenville	54.78	33341	13.3	707.2
42	TN19	Middle Tennessee	Nashville	90.12	64839	4.2	711.5
43	TN24	Cumberland	Nashville	90.05	48106	3.6	715.1
44	TN35	Sequachee Valley	Chattanooga	58.52	22318	3.9	718.9
45	TN38	Appalachian	Knoxville	71.44	26106	3.4	722.3
46	TX101	Tri-County	Dallas	75.43	25149	11.4	733.7
47	TX48	Magic Valley	McAllen	90.62	29158	22.9	756.7
48	TX56	South Plains	Lubbock	79.54	22523	14.9	771.6
49	TX76	Pedernales	Austin	66.12	71231	47.2	818.7
50	TX77	Johnson County	Dallas	66.17	22686	20.9	839.6
51	TX94	Guadalupe Valley	San Antonio	54.14	26071	13.4	853.0
52	VA55	Northern Virginia	Washington	92.82	45299	8.3	861.3
53	WA18	Inland Power	Spokane	64.14	21554	11.2	872.5

Urban/Suburban Telephone Borrowers Who Have Received Loan Approvals From REA Over 1980-1985

	Borrower ID	Borrower Name	MSA or CMSA Location	Holding Company?	Percent MSA or CMSA	Subscribers (1985)	Loans (80-85) ($ in M)	Cumulative Loans ($ in M)
1	GA554	ALLTEL Georgia	Athens	ALLTEL	61.68	21073	11.0	11.0
2	MI536	ALLTEL Michigan	Jackson	ALLTEL	65.50	35342	13.9	24.9
3	NC510	ALLTEL Carolina	Charlotte	ALLTEL	62.94	75781	47.1	72.0
4	PA528	Murraysville	Pittsburgh	ALLTEL	100.00	20300	10.0	82.0
5	PA551	Commonwealth	Scranton	no	68.08	145474	35.7	117.7

[TAB II]

REA Borrowers Are Subsidiaries of Major Telephone Holding Companies

A number of REA borrowers are subsidiaries of major multi-billion and multi-million dollar telecommunications holding companies who have a well demonstrated ability to borrow in private credit markets. Under proposed Administration legislation, any holding company with gross revenues in excess of $100 million would be defined as "major" and any of its affiliated subsidiaries would be ineligible for any further REA direct loans, Rural Telephone Bank loans or REA loan guarantees. A review of such subsidiary borrowers and their holding companies disclosed:

- There are 75 subsidiary borrowers, represented by five major holding companies, who borrowed from REA between 1980 and 1985. These borrowers represent only 7.5% of all telephone borrowers but accounted for 25.5% (or $658.6 million) of their REA loan approvals (direct, RTB, and REA guaranteed) between 1980 and 1985 (see Table II-1). These borrowers also accounted for 26.5% (or $231.3 million) of RTB loan approvals and 78.5% (or $297.3 million) of loan guarantee approvals between 1980 and 1985 for all telephone borrowers.

- All of the telecommunications holding companies have established themselves as strong borrowers in private credit markets. In fact, four of the five holding companies already rely on private credit markets to meet the majority of their debt needs; three of the five rely on private markets to meet more than 75% of their debt needs (see Chart II-1).

- Subsidiaries of CONTEL Corp. and ALLTEL Corp. have been the largest borrowers from REA between 1980 and 1985 (over $400 million combined). Both of these holding companies are very large and well established in private credit markets. CONTEL's annual sales and assets were $2.6 billion and $5.1 billion respectively in 1985 and they had borrowed more than $1.4 billion in private credit markets. ALLTEL's annual sales and assets were $0.7 billion and $1.6 billion respectively in 1985 and they had borrowed more than $300 million in private credit markets (see Chart II-1).

TABLE II-1

MAJOR 1/ TELEPHONE HOLDING COMPANIES AND THEIR SUBSIDIARIES WHO HAVE RECEIVED LOAN APPROVALS FROM REA OVER 1980-1985

Holding Company	Total 1985 Sales ($ in M)	Number of Subsidiary Borrowers Receiving Loans 1980-1985	Percent of All REA Telephone Borrowers	Loan Approvals to Subsidiary Borrowers 1980-1985 ($ in M)	Total Loan Approvals to All Telephone Borrowers 1980-1985
CONTEL Corp.	$2,556.6	13	1.3%	$241.6	9.3%
ALLTEL Corp.	$ 672.0	18	1.8%	$172.9	6.7%
Telephone and Data Systems Inc.	$ 119.1	25	2.5%	$ 98.0	3.8%
Pacific Telecom Inc.	$ 459.0	7	.7%	$ 91.5	3.5%
Century Telephone Enterprises	$ 135.1	12	1.2%	$ 54.6	2.1%
TOTAL		75	7.5%	$658.6	25.5%

1/ Defined as having gross revenues in excess of $100 million.

TABLE II-2

SUMMARY OF URBAN/SUBURBAN BORROWERS AND SUBSIDIARIES OF MAJOR TELEPHONE HOLDING COMPANIES WHO HAVE RECEIVED LOAN APPROVALS FROM REA OVER 1980-1985

	Number of Borrowers Receiving Loans 1980-1985	Percent of All Electric Distribution and Telephone Borrowers	Loan Approvals 1980-1985 ($ in Millions)	Percent of Total Loan Approvals to All Electric Distribution and Telephone Borrowers 1980-1985
Electric Distribution Urban/Suburban	53	2.7%	$ 872.5	11.9%
Telephone Urban/Suburban	5	.3%	$ 117.7	1.6%
Subsidiaries of Major Holding Companies (Net) 1/	71	3.7%	$ 576.6	7.9%
TOTAL	129	6.7%	$1,566.8	21.4%

1/ Excludes four telephone borrowers who are also defined as urban/suburban borrowers above.

CHART II-1

Descriptions of Major Telephone Holding Companies Whose Subsidiaries Have Received Loan Approvals From REA Over 1980-1985

Holding Company	Description of Company	Financial Status
CONTEL Corp.	A major integrated telecommunications firm with telephone operations and business/information systems. Telephone operations consist of 30 telephone companies serving more than 2 million customers in 30 states and the Caribbean.	Annual sales and assets were $2.6B and $5.1B respectively in 1985. Of $1.8B in outstanding long-term debt, more than 78% was generated from non-REA private sector sources. Possible merger with Communications Satellite Corp.
ALLTEL Corp.	A major integrated telecommunications firm with telephone subsidiaries in 19 mid-western, eastern and southern states providing service to nearly 1 million customers. Also branching into cellular telephone and wide-area paging.	Annual sales and assets were $672.0M and $1.6B respectively in 1985. Of $613.5M in outstanding long-term debt, 50% was generated from non-REA private sector sources. The company has a $125M private revolving credit agreement through August 1989.
Telephone and Data Systems Inc.	A major integrated holding company with 60 independent operating companies serving 200,000 customers in 22 primary eastern states. Expanding into cellular telephone and radio paging.	Annual sales and assets were $119.1M and $406.4M respectively in 1985. Of $198.3M in outstanding long-term debt, nearly 32% was generated from non-REA private sector sources.
Pacific Telecom Inc.	A major holding company whose subsidiary operating companies serve 164,600 customers in 9 nortwestern states and 195 communities.	Annual sales and assets were $459.4M and $1.2B respectively in 1985. Of $428.1M in outstanding long-term debt, more than 78% has been generated from non-REA private sector sources. The company has a revolving line of private credit permitting loans up to $180M.
Century Telephone Enterprises	A major holding comapny with 29 telephone subsidiaries serving 224,000 customers in 11 mid-western and southern states.	Annual sales and assets were $135.1M and $433.4M respectively in 1985. Of $207.7M in outstanding long-term debt, more than 85% has been generated from non-REA private sector sources.

Subsidiaries of Major Telephone Holding Companies Who Have Received Loan Approvals From REA Over 1980-1985

	Borrower ID	Borrower Name	Holding Company	Total Loans ($ in M)	Cumulative Loans ($ in M)
1	AL532	Elmore-Coosa	ALLTEL	3.1	3.1
2	AL550	Leeds	ALLTEL	6.9	10.0
3	AR523	White River	ALLTEL	2.1	12.1
4	FL509	ALLTEL Flordia	ALLTEL	28.9	41.0
5	GA554	ALLTEL Georgia	ALLTEL	11.0	52.0
6	MI536	ALLTEL Michigan	ALLTEL	13.9	65.9
7	MI557	Morenci Home	ALLTEL	2.7	68.6
8	MO583	ALLTEL Missouri	ALLTEL	4.7	73.3
9	NC510	ALLTEL Carolina	ALLTEL	47.1	120.4
10	NC545	Sandhill	ALLTEL	3.1	123.5
11	OK559	ALLTEL Oklahoma	ALLTEL	2.6	126.1
12	PA528	Murraysville	ALLTEL	10.0	136.1
13	PA529	Huntingdon	ALLTEL	1.4	137.5
14	PA531	Enon Valley	ALLTEL	6.2	143.7
15	SC505	ALLTEL SC	ALLTEL	7.5	151.2
16	TX618	ALLTEL Texas	ALLTEL	2.2	153.4
17	WV517	West Virginia	ALLTEL	13.1	166.5
18	WV522	Mountain State	ALLTEL	6.3	172.8
19	AZ505	CONTEL of the West	CONTEL	41.7	214.5
20	AR519	CONTEL of Arkansas	CONTEL	10.5	225.0
21	GA555	CONTEL of the South	CONTEL	37.9	262.9
22	IA556	CONTEL of Iowa	CONTEL	17.2	280.1
23	KS522	Kansas State	CONTEL	5.6	285.7
24	KS554	CONTEL of Kansas	CONTEL	20.4	306.1
25	KY528	CONTEL of Kentucky	CONTEL	12.8	318.9
26	ME511	CONTEL of Maine	CONTEL	5.0	323.9
27	MN526	CONTEL of Minnesota	CONTEL	1.0	324.9
28	MO580	CONTEL of Missouri	CONTEL	56.3	381.2
29	NC544	CONTEL of NC	CONTEL	18.9	400.1
30	ND535	North Dakota	CONTEL	8.0	408.1
31	WV518	West Virginia	CONTEL	6.3	414.4
32	AR545	Redfield	Century	2.3	416.7
33	ID516	Century of Idaho	Century	5.7	422.4
34	LA511	Coastal	Century	8.0	430.4
35	LA522	Century Tel. Co.	Century	2.4	432.8
36	LA526	United	Century	4.1	436.9
37	LA530	Louisiana Western	Century	5.7	442.6
38	MI561	Au Gres	Century	2.4	445.0
39	MS505	Home	Century	5.4	450.4
40	MO603	Holway	Century	1.1	451.5

	Borrower ID	Borrower Name	Holding Company	Total Loans ($ in M)	Cumulative Loans ($ in M)
41	MO604	Webster County	Century	5.0	456.5
42	TN514	Adamsville	Century	4.8	461.3
43	TN517	Claiborne	Century	7.9	469.2
44	AK512	Glacier State	PacTelecom	27.4	496.6
45	AK519	Sitka	PacTelecom	18.9	515.5
46	CO504	Eagle	PacTelecom	4.5	520.0
47	ID506	Gem State	PacTelecom	1.8	521.8
48	OR520	East Oregon	PacTelecom	33.2	555.0
49	WA540	Home	PacTelecom	5.6	560.6
50	WY518	Medicine Bow	PacTeleco	0.2	560.6
51	AL501	Peoples	TelDataSy	5.9	566.5
52	ID511	Troy	TelDataSy	0.6	567.1
53	IN561	Home	TelDataSy	2.5	569.6
54	IN563	Ind. Comm. Corp.	TelDataSy	5.5	575.1
55	ME518	Hartland	TelDataSy	3.1	578.2
56	ME524	Somerset	TelDataSy	8.6	586.8
57	ME529	Warren	TelDataSy	1.0	587.8
58	MI554	Augusta	TelDataSy	1.9	589.7
59	MN600	Mid-State	TelDataSy	3.7	593.4
60	MS504	Calhoun City	TelDataSy	2.3	595.7
61	NH504	Kearsarge	TelDataSy	3.8	599.5
62	OK563	Oklahoma	TelDataSy	16.7	616.2
63	OR540	Home	TelDataSy	0.9	617.1
64	PA545	Sugar Valley	TelDataSy	1.3	618.4
65	SC508	Williston	TelDataSy	1.7	620.1
66	SC525	St. Stephen	TelDataSy	1.8	621.9
67	TN510	Tennessee	TelDataSy	25.7	647.6
68	VT504	Perkinsville	TelDataSy	0.3	647.9
69	VT505	Northfield	TelDataSy	1.6	649.5
70	VT507	Ludlow	TelDataSy	3.0	652.5
71	WA539	Asotin	TelDataSy	2.1	654.6
72	WI578	Rock River	TelDataSy	1.0	655.6
73	WI579	Mosel	TelDataSy	1.1	656.7
74	WI584	Scandinavia	TelDataSy	1.0	657.7
75	WI609	Stockbridge	TelDataSy	0.8	658.5

[TAB III]

REA Borrowers Who Use Loans For Recreational Purposes

A number of borrowers have used REA loans to extend and upgrade service to exclusive ski, boating, golf, beach, and lake resorts which benefit the upper income classes. This goes well beyond the REAct's original purpose of providing electric and telephone service to rural areas. Examples include: world famous ski developments at Vail, Aspen, Snowmass, and Steamboat Springs, Colorado, as well as exclusive beach, boating, golf and tennis resorts such as Hilton Head Island, Kiawah Island, and Pleasure Island in the Carolinas and Florida (see Chart III-1). Under proposed Administration legislation, the REA Administrator will not allow any further REA loans to be used for such recreational purposes.

CHART III-1
Examples of Recreational Use of REA Loans

Borrower	Quotes Available From Borrowers' Power Requirements Studies Required by REA
o Colorado 34 Holy Cross	"...Holy Cross serves several ski resorts including the world famous developments at Vail, Aspen and Snowmass. As the recreation industry expanded over the past several years, so did the cities, towns, villages and rural areas to provide necessary housing, goods and services needed by both the tourist and permanent resident..."
o Colorado 36 Yampa Valley	"...The area is recognized nationally as a winter and summer resort, with a major ski area and numerous subdivisions, condominiums and other residential and commercial developments... Most of the growth in the service territory is expected to be associated with the Steamboat Ski Resort... The nearby Yampa Valley Regional Airport is being expanded to accommodate jets for non-stop American Airline charter ski flights..."
o Pennsylvania 21 Somerset	"...One of the top ski resorts in the U.S., Seven Springs Farm, Inc., is served by the cooperative. It features the largest artificial snow surface in the world, according to its owner, and continues to expand its skiing on an almost annual basis. There is a modern 10-story high rise motel along with several hundred condominium apartments and townhouses located nearby... The service area also includes another large residential-recreational development known as Indian Lake. This development includes a 750-acre lake, two golf courses, ski slopes, a lodge, condominiums and townhouses and an airport..."
o New Mexico 11 Kit Carson	"...Colfax County in the Moreno Valley.. is primarily tourist oriented because of the beauty of the mountainous area and is well adapted for seasonal residences... The district has grown rapidly in recent years because of the development of a large recreational and residential complex by the Angel Fire Corporation. This includes a ski area complete with snow making machinery, condominiums, motels, a country club, golf course, fishing lakes, restaurants, a shopping center, etc..."
o S. Carolina 25 Berkeley	"...The Kuwait Investment Company purchased a coastal island called Kiawah... This is a very exclusive development... To date, the Kuwait Investment Company has invested about $60 million in developing the island... Seabrook Island is similar to Kiawah and is in fact adjacent to it..."
o S. Carolina 40 Palmetto	"...Hilton Head Island's resort development has been the largest contributing factor to Palmetto Electric's rapid growth... Figures show that over 330,000 tourists visit Hilton Head each year, and that the average daily population is nearly double the permanent Island population of 7,500 residents, as vacationers and conventioners flock to Hilton Head's thirteen (13) golf courses and 180 tennis courts. Two major golf tournaments and two tennis tournaments help to draw more and more Island visitors. Seventy-one (71) restaurants do a thriving business throughout the year..."
o Alabama 20 Baldwin County	"...The rapid increase in consumer additions is concentrated primarily in the 'Pleasure Island' area which includes the coastal area between the Gulf of Mexico and the Intracoastal Waterway... This relatively low-density development has given way to high-rise condominium and resort hotel development over the last several years... most of the owners and investors of the condominiums, townhouses, and other facilities are seasonal visitors..."

[TAB IV]

THE STRONG FINANCIAL HEALTH OF ELECTRIC AND TELEPHONE BORROWERS

The improving financial standing of both electric distribution and telephone borrowers reflects a pattern of change that has been occurring since 1980.

Electric Borrowers

In the electric program, trends show that borrowers have improved their financial standing with respect to total assets, asset equity, times interest earned ratio (TIER), operating revenue, and profit margins (net income). Overall, total assets have increased by 53.1% since 1980 to $19.6 billion in 1985 for electric distribution borrowers.

Table 1. Total Assets: REA Distribution Borrowers

Year	Amount
1980	$12.8 billion
1981	$14.4 billion
1982	$15.9 billion
1983	$16.9 billion
1984	$18.3 billion
1985	$19.6 billion

Electric distribution borrowers have increased composite equity as a percent of total assets since 1981. This shows not only that business is doing well, but that strength exists to deal with any further difficulties systems might encounter.

Table 2. Composite Equity to Asset Ratios:
REA Distribution Borrowers

Year	Ratio
1980	29.8%
1981	29.3%
1982	29.6%
1983	31.6%
1984	33.6%
1985	34.9%

REA's calculation of the composite TIER of all borrowers shows a similar improvement, which means that borrowers have adequate resources to pay for expected interest costs.

Table 3. Composite TIER: REA Distribution Borrowers

Year	Ratio
1981	2.09
1982	2.18
1983	2.46
1984	2.69
1985	2.44

Operating revenues have improved substantially since 1981 having increased by 48.1%.

Table 4. Total Operating Revenue: REA Distribution Borrowers

Year	Amount
1981	$ 7.7 billion
1982	$ 9.0 billion
1983	$ 9.9 billion
1984	$10.8 billion
1985	$11.4 billion

Borrower profit margins have more than doubled since 1981.

Table 5. Composite Profit Margins (Net Income): REA Distribution Borrowers

Year	Amount
1981	$413.0 million
1982	$515.0 million
1983	$701.0 million
1984	$884.0 million
1985	$819.4 million

Telephone Borrowers

In the telephone program, trends show a similar pattern. The value of borrower telephone assets has increased each year since 1980.

Table 6. Total Assets Owned by REA Telephone Borrowers

Year	Amount
1980	$ 6.5 billion
1981	$ 7.0 billion
1982	$ 7.8 billion
1983	$ 8.4 billion
1984	$ 9.1 billion
1985	$ 9.5 billion

Telephone borrowers have increased composite equity to asset ratios by 20.9% since 1980 to 30.1% in 1985.

Table 7. Composite Equity to Asset Ratios: REA Telephone Borrowers

Year	Ratio
1980	24.9%
1981	25.3%
1982	26.3%
1983	27.3%
1984	28.5%
1985	30.1%

Composite TIER'S have increased by 25.9% since 1980 to 2.82.

Table 8. Composite TIER: REA Telephone Borrowers

Year	Ratio
1980	2.24
1981	2.36
1982	2.40
1983	2.55
1984	2.75
1985	2.82

Operating revenues also have increased.

Table 9. Total Operating Revenues: REA Telephone Borrowers

Year	Amount
1980	$1.8 billion
1981	$2.0 billion
1982	$2.4 billion
1983	$2.6 billion
1984	$2.9 billion
1985	$3.1 billion

The trend in net profit income shows substantial improvement also. The net income (regulated) of all borrowers since 1980 is as follows.

Table 10. Net Profit Income: REA Telephone Borrowers

Year	Amount
1980	$216 million
1981	$262 million
1982	$314 million
1983	$369 million
1984	$446 million
1985	$488 million

[TAB V]

President's FY 88 Budget for REA

Proposed Loan Levels

	Enacted FY 87	Current Est. FY 87	Proposed Budget FY 88	FY 89	FY 90	FY 91	FY 92
DIRECT							
Direct Electric	622	437	258	129	0	0	0
Direct Telephone	239	105	32	16	0	0	0
RTB	177	149	93	46	0	0	0
Total Direct	1,038	691	383	191	0	0	0
GUARANTEES (Federal Financing Bank)							
Electric	813	372	0	0	0	0	0
Telephone	120	30	0	0	0	0	0
Total FFB	933	402	0	0	0	0	0
NEW GUARANTEES (Private Sector)							
Electric	0	0	766	1,016	1,265	1,265	1,265
Telephone	0	0	74	99	123	123	123
Total Private	0	0	840	1,115	1,388	1,388	1,388
TOTAL REA	1,971	1,093	1,223	1,306	1,388	1,388	1,388

- o Direct loan programs (insured, RTB) and the 100% REA guaranteed FFB loans are replaced by a new lending program where most borrowers would be eligible for private sector financing with a 70% REA guarantee of principal.

- o Loan asset sales of $1.0 billion gross ($653 million net) for the direct loan program are included for each year between FY 88 and FY 92. RTB loan asset sales of $500 million gross ($449 million net) are included in FY 88-89 and $250 million gross ($225 million net) in FY 90.

- o Receipts in the Revolving Fund and RTB (due to increased interest rates, loan sales and loan repayments in excess of new loans) will be used to repay outstanding Treasury and FFB debt. For the RTB the funds would be used to repay outstanding Treasury debt and Class A stock.

- o REA will propose permanent authority for borrowers to utilize private capital to prepay direct loans at the loan's present value discounted at the Aa utility rate from its face value and to prepay outstanding FFB loans guaranteed by REA (with a 70% guarantee of principal) and RTB loans at face value with private capital without a prepayment premium. Borrowers choosing to participate in the "golden handshake" program must agree not to seek additional financial assistance under the REAct.

- o Legislation will discontinue REA assistance to: urban/suburban borrowers with more than 50% of their customers in a Metropolitan Statistical Area and more than 20,000 customers; borrowers who are subsidiaries of holding companies with gross revenues in excess of $100 million; and borrowers for the purpose of providing or improving service to recreational areas.

- FY 88 Budget will include proposed supplementals for FY 87 enacted loan levels that would reduce 87 enacted levels to the equivalent to 3/4 of the difference between FY 87 enacted loan levels and FY 87 President's Budget loan levels.

- Interest rates on direct loans available through FY 89 will be increased from current levels of 5% to Treasury plus 1/8 percentage points in FY 88. Interest rates on hardship loans will be increased from 2% to 5%.

- REA will charge a loan origination fee on all new loans (including 70% guarantees) to cover administrative costs.

- The Administration's proposals, when compared to current services, results in $2,586.2 million in outlay savings in FY 88 and $15,983.0 million over the period FY 88-92.[1] These savings are essential to reducing the deficit.

	Outlays in Millions					
	FY 88	FY 89	FY 90	FY 91	FY 92	FY 88-92
Current Services	2,970.2	3,083.6	2,599.9	3,277.0	3,354.7	15,285.4
Administration's Proposal	384.0	262.9	-188.9	-357.7	-797.9	-697.6
Outlay Savings	2,586.2	2,820.7	2,788.8	3,634.7	4,152.6	15,983.0

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[1] These estimates reflect savings under the President's FY 88 Budget as submitted to Congress in January. As such, the new lending program of private sector financing with a 70% REA guarantee of principal would not have an outlay effect on the Federal Budget. Under the Federal Credit Reform Proposal, which is to be submitted to Congress in March, the subsidy inherent in the new lending program will be scored as outlays in the REA budget.

BUSINESS ENVIRONMENT HAS CHANGED

Mr. HUNTER. The business environment of the nation has changed and certainly that of rural America. The prime interest rate has dropped from 21 percent some 6 years ago to 7.5 percent at the present time. Interest rates for AA-rated utilities have decreased from 16.6 percent in September 1981 to 8.7 percent at the present time. REA borrowers can obtain financing at reasonable rates from nongovernment sources.

The 1988 budget does not call for a phase-out of the REA program. This budget is different from past proposals that we have made. The 1988 budget proposes that REA guaranteed loans from private lenders be substituted for the present REA 5 percent interest direct loans. There would be a familiar 70 to 30 ratio, similar to today's ratio, of a 70-percent REA loan accompanied by a 30-percent loan from the private sector.

The 1988 budget would propose loans made by a private lender with 70 percent of the loan principal guaranteed by REA. This is a good partnership. A guarantee plus a strong borrower, accompanied with that involvement of the federal government, makes a partnership which is acceptable to private sector lenders.

Naturally, there will be a time of adjustment. You do not do these things without providing for a transitional period. So this budget proposes a 2-year adjustment, a continuation of direct loans for that length of time.

REA BUDGET PROPOSAL

Borrowers serving urban/suburban and recreation areas as well as large telephone holding companies would graduate to private-sector financing. Electric loans in 1988 would include $258 million of insured and $776 million guaranteed private-sector loans. REA would guarantee 70 percent of the principal of those private loans giving it strength and acceptability with the private-sector lender.

The telephone proposal includes $32 million in insured and $74 million in private-sector guaranteed loans, with a 70-percent guarantee of the principal and $93 million in Rural Telephone Bank loans.

No request was made for reimbursement to the revolving fund. The fund was advanced $7.9 billion in 1973 to be used interest free. That $7.9 billion was an offering on the part of the federal government to provide the initial capitalization of the revolving fund interest free for many years.

Over $500 million has been appropriated to the fund to cover losses, which did not take place. The interest on the $7.9 billion had been forgiven; therefore, the fund had no losses.

No funds are requested for capitalization of Rural Telephone Bank stock. We recommend that the Rural Telephone Bank Class A stock be redeemed beginning in 1989 instead of in 1995, as current law mandates.

INTEREST RATE INCREASE

The 5-percent interest rate on direct REA loans would be raised to the cost of money to Treasury plus one-eighth percent. This increase will have little impact upon the consumer at the end of the line, who is our main concern.

The interest on hardship loans would be raised from 2 percent to 5 percent. Again, this would have little impact upon the consumer. The budget proposes permanent authority for borrowers to prepay loans, a program which has been well received. We have two electric borrowers in Texas and one in Nebraska that have prepaid their loans. These systems have enhanced their equity position and, more importantly, have freed themselves from government regulations that exist under REA financing.

The government has also benefited from the reduction in government outlays for this particular purpose because of the prepayments. REA received $39.7 million since December 1986 from prepayments.

REA proposes to sell loan assets, as is being done across the federal government. We are recommending that 1 billion dollars' worth of loan assets from the revolving fund and $500 million from RTB be sold in 1988.

The 1988 budget proposes a loan origination fee to be charged at the time the loan is made. It would relieve Congress of appropriating $27,244,000 for salaries and expenses in 1988 for this agency.

We are requesting a staffing level of 500 people. That is a reduction of 35 staff-years. This level is adequate to carry out the responsibilities of the REA program.

I do not believe that I could make this presentation to you without mentioning what has become one of the most difficult and challenging responsibilities that REA has ever had. Incidentally, I want to give a commendation to my staff for the way they have handled that responsibility.

The challenge is dealing with the economic and fiscal problems that some of our generation plants are having. An anticipated increase in the use of electricity has not developed. That has thrown all projections on markets, prices, and availability of marketing the new electricity that can be produced by a new electric plant completely out of kilter. Those projections have not held up, and naturally they have been untrue in other aspects of our economy.

The other thing that has happened has been that the cost of those plants has escalated terribly. The whole picture of what will be done with these generating plants has become very difficult. Our picture as to what the REA is going to do when those plants reach the point and those systems reach the point that they do not have the capability to make their payments to REA is questionable.

I commend the REA staff, who have worked with Treasury, Justice, OMB, and other organizations, and certainly with the Congressmen and the Senators in the areas that are affected, as they have cooperated with what we called our troubled plants committee. They have taken on a responsibility that they have never had in the past, because they have not had to deal with nonpaying borrowers in the past. They did not exist in REA. So that has been a new responsibility, and they have risen to that. We have been under tremendous stress; we continue to be under tremendous stress.

However, I think that this has pointed up that the people within the realm of REA, the people who make the decisions and make the recommendations that come to the administrator, have great capability and have risen to a responsibility that had never been handed to them before. Yet they have dealt with it in a very real way.

The 1988 budget does reflect bold goals on the part of the administration, bold changes, changes from a direct loan program, to a guaranteed program shared by the private sector with the federal government. The federal government will guarantee 70 percent of the loan and 30 percent of it will be at the risk of the private lender.

The budget recognizes the changes that have taken place in the rural community, and it directs the assistance that comes from REA to those parts of the community that really need the assistance of well financed, well supported rural electric and rural telephone industry.

So for those reasons, I say to you with no embarrassment and with my very strong urging that you—and I know you will—give this budget a very open hearing. Perhaps in your judgment you will dispense with a part of it, but I would strongly urge you to recognize that there are some very strong and very good ideas of change that would reflect the changes that have happened to two great industries: the industry of rural electricity and the industry of rural telephony.

Changes in the industry have happened. Changes in this government have happened. And the need for new priorities to deal with a budget deficit, which is staggering at the present time, is very high.

Mr. Chairman, I appreciate this opportunity to appear before you. I thank you for that opportunity and certainly will be glad to respond to questions that you or the other committee members may have.

PREPARED STATEMENT

Senator BURDICK. Thank you. The statements of Mrs. Lawrence and Mr. Hunter will be made part of the record.

[The statements follow:]

STATEMENT OF KATHLEEN LAWRENCE

Mr. Chairman and members of the Committee, I am pleased to be here and introduce the REA budget proposal for FY 1988.

The Rural Electrification program has been a truly remarkable program. It has nearly achieved the goals established by Congress of bringing quality electric and telephone service to rural America. Through Government assistance and guidance supplied by REA, borrowers have developed into strong financial organizations that are well accepted in the private investment community. The current need for Government assistance has diminished.

We recognize the strong support Congress has given REA in the past and we are requesting your consideration of a major new initiative. Our proposal recognizes the financial strength of REA's borrowers, their acceptance in the private sector, and the availability of private market funds. We are proposing to guide the REA program in a new direction which will reduce the electric and telephone borrowers' dependence on the Federal Government and utilize private sector financing. This move will assist in balancing the Federal Budget.

For FY 1986 and 1987, the proposed REA budget phased out all REA loan programs. The Congress did not accept these proposals. I have worked with Secretary Lyng to develop a plan that we anticipate will be more favorably received by the Congress.

We believe the time is here to graduate financially sound borrowers to the private credit market, while continuing to provide a source of funds for borrowers who truly need assistance. The cost of borrowing from private sources is now lower than at any other time in recent years. We want to encourage REA borrowers to use private capital when they are able to obtain their own financing. By promoting borrowers to become independent of government lending, we will be able to reduce costly REA loan programs.

This plan will have no adverse impact on the existing portfolio of REA loans and loan guarantees. Prepayments may increase, but only if borrowers voluntarily choose to refinance their existing loans and loan guarantees through private sources. REA will continue to service its existing loans and loan guarantees at no additional cost or loss of benefits to borrowers. Some loans would be sold on a non recourse basis, but such sales are not likely to result in any lost benefits to borrowers.

The FY 1988 budget proposes a phased moving from direct federal involvement to private sector financing with a 70 percent government guarantee. The guarantee will allow borrowers to obtain capitalization from private sources while substantially reducing any risk. Direct and Rural Telephone Bank loans would still be available over the next two fiscal years. During this transitional period, REA will continue to work with borrowers that are not ready to graduate to private sector lending. Reliable electric and telephone service to rural communities will continue.

Additionally, the FY 1988 budget proposes increasing the interest rate on direct loans, selling loan assets, continuing to provide for the prepayment of direct and guaranteed loans, and charging a loan origination fee to fund the administrative expenses of the Agency.

The improved economic status of the rural utility industry challenges us to move ahead with less costly programs for the taxpayer. I believe it is a challenge we must accept.

I am pleased to endorse the REA budget proposal and urge your support of the budget request. I would now like to turn over the presentation to the REA Administrator, Harold Hunter, so he can review the proposal in more detail.

STATEMENT OF HAROLD V. HUNTER

Mr. Chairman and members of the Committee, it is a privilege to appear before this committee in support of the Rural Electrification Administration's (REA) annual budget and program proposals. I have a short statement and then I would be happy to answer any questions.

Congress has established many goals for REA. The mission as a federal credit agency to provide funds for quality electric and telephone services to rural America is almost accomplished. Virtually everyone in rural areas has reliable electric and telephone service. According to REA statistics, 98.8 percent of U.S. farms have electricity and 96 percent have telephones. Through REA's direct loan and loan guarantee programs, more than $58 billion has been approved to rural electric and telephone borrowers.

Over the years REA borrowers have strengthened their financial situation and developed into stronger, more viable business enterprises. During 1985, electric distribution borrowers' aggregate revenues totalled $11.4 billion, an increase of $4.9 billion or 74 percent more than in 1980. More significantly, their net margins totalled $819 million, an increase of $464 million, or 131 percent more than the 1980 level. In addition, the overall equity level for distribution borrowers improved from 29.8 percent to 34.9 percent during the 1980-1985 time period. In constant dollars, rural electric consumers pay far less for electricity today than they paid 35 years ago.

Telephone borrowers' revenues totaled $3.1 billion in 1985, an increase of $1.3 billion, or 76.8 percent over 1980. Their net income or margins were almost $488 million, an increase of more than 125 percent from 1980. Financial ratios also show improvement. For example the ratio which relates net income to plant investment, rose from 2.9 percent in 1980 to 4.6 percent in 1985, an improvement of 59 percent. In addition, over 90 percent of the subscribers on REA-financed telephone systems have private-line, one-party service. However, this achievement has been costly. Subsidized loans to REA borrowers have cost the Treasury billions of dollars.

The improved financial strength of REA borrowers and the continued availability of quality electric and telephone service to rural areas testify to the fact that the REA loan programs have met the original objectives of the RE Act. Rural America is served by electricity under rates and conditions that permit its full and productive use. However, there is a clear indication that a significant amount of financing being provided by REA today is going to serve areas never intended when the Congress established REA. A considerable amount of REA subsidized funding has gone to provide electric service to heavily populated and prosperous urban and suburban areas as well as exclusive recreation communities. Many of REA's fastest growing borrowers that serve affluent suburbs and resort areas are able to raise funds in the normal marketplace without government assistance.

In the telephone program, loans are being made to telephone borrowers that are subsidiaries of or are large multi-million dollar holding companies. These borrowers have excellent credit ratings in the private capital markets, yet receive subsidized loans under current law.

For the record I am providing an attachment which contains detailed information suggesting why these subsidies are no longer appropriate. Continuation of the current REA lending programs as they are presently structured results in unnecessary additional costs to the U.S. Treasury. At a time of large federal deficits, serious consideration should be given to reforming the lending programs of REA. The private credit market will serve the needs of most REA borrowers and federal involvement should be reduced.

Major New Initiatives

Reforms to federal loan programs are needed to respond to major changes that have occurred in credit markets over the past several years. The prime interest rate is down from 21 percent approximately 6 years ago to 7.5 percent. Interest rates for Aa rated utilities have decreased from 16.6 percent in September 1981, to the current rate of 8.7 percent. REA borrowers can obtain credit in the private sector and because of their financial health, major new initiatives for the REA programs are being proposed. Beginning in FY 1988, REA will guarantee private sector loans. The funds available for these loans will continue to grow as REA phases in the new program. The shift to private sector loans would be phased in over the next two fiscal years with direct and RTB loans available during the transition period. This transition period would allow REA borrowers that need financial assistance to shift from government dependence and provide them access to private sector funds. All borrowers serving urban, suburban, or recreation areas as well as telephone borrowers who are subsidiaries of or are larger holding companies would graduate to private sector financing without a guarantee.

FY 1988 Budget Proposals

Loan Programs

Consistent with the new initiatives, the REA budget proposal provides $258 million in insured electric and $766 million in private-sector electric loans. REA would guarantee 70 percent of the principal amount of privately borrowed funds. By requiring the private lender to accept a portion of the risk (30 percent) associated with the loan, the private lender will more closely scrutinize the loan approval and construction process instead of merely providing funds to make the loan.

The telephone budget proposal includes $32 million in insured telephone loans, $74 million in private-sector telephone loans with a 70 percent REA guarantee, and $93 million in Rural Telephone Bank loans.

No funds are being requested for reimbursement to the revolving fund. The cost of operating these programs is not reflected in the revolving fund. The fund has not incurred a loss since inception in 1973 because it is exempted from paying annual interest costs to the Treasury on advances totaling $7.9 billion. Congress has appropriated over $500 million to the revolving fund for losses that the fund did not have because interest owed on the original $7.9 billion debt was forgiven. Since interest subsidies and the associated losses are sustained by the Treasury and not the revolving fund, no appropriation for losses is requested for 1988.

In addition, the budget proposal does not request funds for capitalization of Rural Telephone Bank stock. The REA budget proposes that the Federal Government's investment in Class A stock of the Rural Telephone Bank be redeemed. This would begin after the RTB repaid borrowings from the Treasury with proceeds from loan asset sales. We are proposing RTB begin redeeming Class A stock in 1989 instead of 1995 as current law mandates. The Bank no longer requires additional capitalization.

Interest Rate Increase

In the interim period of moving to the revised loan program, REA proposes to adjust the interest rate on direct loans from 5 percent to the cost of money to the Treasury plus 1/8 percent. This adjustment would help eliminate an unintended subsidy on REA loans and reduce the cost of the program to taxpayers. At the same time, the interest rate on hardship loans would be adjusted from 2 percent to 5 percent. If enacted, this interest rate adjustment would only be the second rate adjustment in the more than 51 year history of REA. This action would return the interest rate charged by REA to the original intended rate which is the cost of money to the Treasury. The revolving fund was not meant to provide subsidized funds but rather to be a reliable source of funds for borrowers who would use it to provide electric and telephone service to the rural areas.

Prepayments and Loan Asset Sales

The fiscal year 1988 budget recommends continuation of the major prepayment authorities for REA direct loans. The budget proposal also provides permanent authority for borrowers to prepay outstanding FFB loans guaranteed by REA and RTB loans without a prepayment premium. The prepayment of loans will provide

REA borrowers a giant step toward independence. Borrowers have made many inquiries about the terms and conditions of paying off their loans. REA has expedited the publishing of regulations in the Federal Register. Three electric cooperatives, two in Texas and one in Nebraska, have already taken advantage of the prepayment provision. They used their own resources and obtained loans to pay their REA loans in full. Borrowers enhance their financial position by making full payment on REA loans. In addition, they are now free of Government regulations, such as restrictions on diversification.

The government also benefits from prepayments. By receiving a lump-sum payment, government outlays are reduced in the year the loan is prepaid. REA has received a total of $39.7 million in prepayments from the three borrowers since December 1986. Because of wide interest in this program, REA expects to receive additional payments during the remainder of fiscal year 1987. The ability to prepay demonstrates the financial strength of REA borrowers. Borrowers are able to obtain outside financing and manage their businesses successfully while continuing to provide quality service to rural America.

REA also proposes to sell loan assets from the existing portfolio. The fiscal year 1988 budget reflects $1 billion in loan asset sales from the revolving fund and $500 million from the Rural Telephone Bank. These sales would allow the Agency to redeem outstanding Treasury and FFB debt of the revolving fund and allow the RTB to repay borrowings from Treasury and repurchase Class A stock.

The REA Administrative Budget Proposal

In addition, REA proposes assessing a loan origination fee to fund Salaries and Expenses. This fee would be consistent with standard banking practices. The fee would replace a direct appropriation for REA's Salaries and Expenses. This proposal will further reduce the cost of the REA programs to the U.S. taxpayers. The amount needed to administer the program in FY 1988 is $27,244,000.

The budget request provides for a staffing level of 500. This reduction of 35 from our current staff-year ceiling can be achieved through normal attrition. The level of 500 staff years will be adequate to administer the proposed program during fiscal year 1988.

The fiscal year 1988 budget proposal reflects the government-wide goal of meeting deficit reduction targets, replacing costly loan programs to borrowers that are able to obtain their own financing, and encourages the increased use of private capital markets. This proposal is sound policy. It recognizes the financial strength of REA borrowers and continues to meet the needs of rural areas. I support the President's FY 1988 budget proposal for the REA program and urge your support also.

This is the end of my prepared remarks. I will be happy to answer any questions you may have.

SENATOR BURDICK'S REMARKS

Senator BURDICK. Does any other member of the panel wish to speak before I ask some questions?

Thank you, Mr. Hunter, for your testimony. Your detail of what has happened through history finds agreement with me. We both know what REA has meant to this country, and we know how necessary it was to its growth. In that we are in complete agreement.

Where we part company at the present time is that you think the job is done, that it can be transferred now to the private sector. You, or your department, came before this committee in the 1985–86 budget and asked that all money be taken out of the program.

Now you have amended it somewhat by doing the same thing with the exception that the REA's and RTB's should go to the private sector for 70 percent of the loan. That is the position you take now, contrasted with the position of 1985 and 1986 where you wanted to end the entire program, I believe it was, in 5 years.

PRIVATE SECTOR FINANCING

Let's look at what you have proposed now—the private sector giving 70 percent loan on these properties. We all know the situation with these properties. You described it very well. But those systems were established 30 years ago. Much of the wiring, underground cables, and equipment is old and has to be replaced. Where they made great advances and did a lot with their money, they are at the point where a lot of this work has to be redone. So the value that was once there is not there any longer.

I know in my own state we are going to have to renew some underground cables at a very high cost. So when you say the job is done, it is not done because we have got another period to cover. That is the resuscitation of the system. So it is going to take a lot of money, or quite a bit of money, I would think.

But to go to the private sector, like you would in an ordinary loan like if I borrow on my house or on my farm, that is not the situation today. They do not have the equity to go into private markets and get this money.

I do not know where they are going to get this 70 percent loan. Maybe you do, and maybe you could tell me where it is coming from. I know what bankers say when you go down to the bank in Fargo, ND, and you want to get a loan on a piece of land. They want to have some value there.

This property is pretty much covered with liens and obligations. So it is not practical to think we can go into the private sector and get the money necessary to upgrade this system and keep this system that has meant so much to not only the REA's but to the whole country.

So all we are asking is that a system that has been successful—and you yourself have described it as being successful—should not be ended at this time. As I say, you tried to end it in 1985 and 1986, but I do not think that your new proposal is any better. I think that the system will die on the vine if they have to go into the private markets and present the same kind of a case for a loan that anybody else would have to present. I do not think any loans would be made. Do you know of any?

Mr. HUNTER. Mr. Chairman, you have put your finger precisely on the issue that we need to address. We constantly have visitors in our office coming to us and talking to us and asking the question: Is there a way that we can get involved? He is a lender from somewhere, and he comes in and he asks us: We are aware of the REA borrowers and we are aware of changes being made in the federal government as far as financing is concerned, and we would like to explore with you the possibility of our making a loan to that borrower out there.

I think we need to recognize that there already exists a program today whereby 30 percent of the funding for distribution cooperatives comes from the private sector. Thirty percent of that loan is coming from the private sector. The private sector is already loaning that amount of money in conjunction with the fact that there is a direct loan.

The change we are talking about here is we leave that alone, and that loan is still made by the private sector except that instead of having a direct loan, we have a guaranteed loan that comes from the private sector also but it comes with a strong guarantee from REA.

QUESTION OF SECURITY

Let's talk about security, though, because I think this is very pertinent. I have just come from Oklahoma, where I had an opportunity to watch and listen to a discussion on the sale of some property. It was a farm property. That is why I was interested in it.

As you know, Oklahoma's economy is in the pits. It is really having its troubles, just like the economy is, Mr. Chairman, in your area of the nation. So you know what is happening to rural America. You know what is happening to farmland as far as being security. It is not very good security. You cannot borrow much money on farmland today. In some cases, those loans are being foreclosed because that security is not as strong as it once was.

Local bankers have told me within the last 3 or 4 days that they base their security on revenue flow and not on the owned property. They want to know whether or not the borrower can pay back a loan, whether he can meet the interest and principal payments that he would subject himself to if he borrowed the money.

REVENUE FLOW

Let's talk about revenue flow. That is why I have emphasized that in my remarks. This is what I hope that you will find time to look at. The data that we have put together on revenue flow, and the increased revenue, on the part of our electric borrowers and telephone borrowers is amazing. They do have a good repayment record. They are used to paying those loans. They intend to pay their loans. That is one of the good parts of this whole picture.

But the other thing is that they have almost complete control of a revenue flow, because the industry is a monopoly. They do not have the degree of competition that a farmer has. They have very secure knowledge of what the revenue flow is today and will be for the future. A lender can determine that flow also and make a decision on a loan request.

I will assure you, sir, that we have many people talking to us about making loans to REA systems. We also have what amounts to 30 percent of the capital requirements for our revolving fund borrowers coming from the private sector. So we are not breaking new ground completely.

Senator BURDICK. Mr. Hunter, I just want to remind you that we are having difficulty getting farm loans in the heartland of this country where the government guarantees 90 percent. They are just not making the loans.

Now we have an additional problem with the REA's. Whereas your farms may be in good operating condition and good farming practices have been followed, with our REA and RTB systems throughout the country, they have been deteriorating, deteriorating badly. So they are asked to tell their banker, well, we have got so many lines, so much business, but there are about 50 miles of line we have to relay now and there are a lot of things we have to do to bring this up to speed.

And that is all over the country. You know as well as I do what it is. They are going to have to resuscitate the whole system. Now, you go to the banker and say I have to spend so many million dollars for this and I owe this much. That does not make his credit balance look very good.

I do not like to disagree with you, Mr. Hunter, but I think it is very, very difficult for the average REA to get a loan through normal commercial channels. I really think so. And I think it may be the end of that REA or it may be absorbed. I do not know what is going to happen to them. But certainly compared to the system that we have had and can keep, I do not think there is any comparison.

Mr. HUNTER. Mr. Chairman, with due respect, as you compare this with the farmer who is trying to get a loan on his farm, again, he faces the same problem. He may have the asset; he may have the ownership of a farm, but the thing that he does not have at the present time, in most cases, is the revenue flow. He does not have the income coming in. Of course, it is the revenue flow that really applies to meeting the loan responsibilities.

SUBORDINATION

Senator BURDICK. I have one more question before I turn the questioning over to my colleagues, and then I will be back. My one question is: Will the REA under your system subordinate its position to the private banks?

Mr. HUNTER. Yes. You see, we give a full guarantee on the guaranteed part, on the 70 percent.

Senator BURDICK. What about the 30 percent?

Mr. HUNTER. On the 30 percent, we want to have that lender somewhat at risk. One of the purposes of this action is to make it possible for us to have the ability to rely upon the judgment of the lender. He will exercise his judgment, in this case generally on the question of whether there is a revenue flow that will protect his loan. And the revenue flow is very good and far better than most farmers' because they know how much they are going to receive in revenue.

Senator BURDICK. Many of these REA's that are in difficulty already have a loan with you.

Mr. HUNTER. We are talking about a different part of the agency, and that is why I referenced the generation plants. Some of those are in real trouble.

Senator BURDICK. Whatever the department is, if they have a loan with the REA, they have borrowed money. Now the question is: Under this system of yours, when they go to a private bank, will you subordinate your interest to the bank?

Mr. HUNTER. Yes; we would support the position.

Senator BURDICK. And you will give the bank the first mortgage?

Mr. HUNTER. That is right.

Senator BURDICK. But only on 70 percent.

Mr. HUNTER. That is right.

Senator BURDICK. Senator Stennis.

REMARKS BY SENATOR STENNIS

Senator STENNIS. Thank you, Mr. Chairman.

Mr. Chairman and fellow members of the committee, it is a treat, a treat to anyone, especially to me, to get to come and hear this testimony under these conditions by competent people: Mrs. Lawrence and Mr. Hunter and, doubtless, others here.

Now, I was born in a rural county. I still live in that same county, never have lived anywhere else. I know what it is to be without rural electricity and rural telephones. And I know what it is to have them. And I have close association with people who were without these things at one time and now have them.

I am not an expert on money matters or anything like that, but today we are discussing the management of a business. Rural electricity and rural telephones are complicated businesses in a way and it takes real knowledge and ability to manage them.

I have been in the Senate long enough to see a good many complaints about things and the way they are going on, various agencies and so forth, but I have never had any complaints about the way these are managed out among the rural people they are serving.

It makes me think of the old days, of the old 1930 Depression we used to call it. There was darkness everywhere then, not only due to the lack of electric lights but due to the lack of money and other things.

Now we have come back somewhat. It is due in part to these better managed segments of the federal government. I think we would be shortsighted indeed if we tried now to abolish or seriously affect, adversely, the continued operation of these agencies.

Management of this kind is not what causes inflation or causes the trouble we have in our financial affairs. Where would we be without these agencies to meet the situation, at least in part, and hold us together and make us a going concern? So I am in full sympathy, of course, on a personal basis with anyone who wants to improve any agency of the government, any segment of it.

With all deference, I think you are just knocking on the wrong door to materially adjust and modify in any way, the REA Program. We must not let that happen.

I consider it a privilege to have the benefit of serving here with you gentlemen on this committee for a good while. We have always pulled together. We cannot give up on an issue like this. Among our committees we have always been unified and pulled together, and that is what I propose that we do again.

Thank you very much for your leadership and your dedication in this matter, Senator Burdick, as well as that of my colleague, Senator Cochran. Thank you very much.

Senator BURDICK. We will continue to hear from the state of Mississippi. Senator Cochran.

COMMENTS ON REA

Senator COCHRAN. Thank you, Mr. Chairman.

I appreciate very much the fact that we are each furnished a copy of this history of the rural electric and telephone programs. It is interesting, I think, to look at the graph on page 6 which supports the statement in Mr. Hunter's testimony about the fact that virtually all the people in rural America now have access to electricity and telephone service.

I think it is just phenomenal that over the past 50 years we have seen this program contribute in such a successful way to improving the quality of life for people in the rural countryside. In our state, as Senator Stennis so eloquently pointed out, REA has really made a big difference in the lives of many thousands of people.

I hope that we can continue to support the rural electric and telephone programs at levels that will permit the continuation of this kind of service. I do not know what that dollar amount is. I do not know from my personal experience or knowledge what that amount is.

SERVICE TO URBAN/SUBURBAN AREAS

It concerns me that we have testimony that this program is not really benefiting the people it was originally designed to serve, and that is the people of rural communities—the less densely populated areas that do not have access to telephones and electricity without the benefit of this kind of program.

In the testimony, as I review it, there is a suggestion that there are so-called recreational communities and resort areas that are benefiting from this program. I think that is the characterization that Mr. Hunter gives it.

Is there any way that through regulation that can be addressed without jeopardizing the access to a fully funded program in the rural parts of the country? If so, what is your reaction to trying to deal with the resort issue? I do not know that we are in favor of furnishing subsidized power to resort areas. What can be done about that through the administration of the program?

Mr. HUNTER. Senator Cochran, you put your finger right on the thing that motivates some of the things that we propose in this budget request. One of the things that will happen to the program is it will become stronger for those who need it, if we decrease the amount of support that we give to some of those who do not need it.

I am not talking about good or bad management, determining need. I am talking about the fact that some areas of this country are harder to serve. They have less revenue than other areas have. We have some areas of this country that are still just as rural as they were 50 years ago. We have other areas that have actually urbanized and become cities, but we have a ruling that says once eligible, always eligible. And we continue to serve them at the same rate as we do those that are still rural or in difficulty.

This proposal contains a recommendation that those areas which are recreational, those areas that are resort areas, those areas that are highly urbanized—and some of them are very highly urbanized— that those will no longer be a basis for service by REA funding.

In many cases, the system that we are loaning money to is a mixture of some urban and some rural. We take that into consideration. If they have a majority of rural areas, they will continue to get service as they have in the past. But if they have a large majority of areas that have become urbanized and metropolitan, if they are part of a metropolitan center to a large degree, then they may lose their eligibility to receive loans from REA. But we recognize that. We address that issue.

Again, as you look at urbanized areas, and the availability of revenue flow, of course they have a better certainty of their revenue flow. They have such a degree of revenue flow that their need is not there any more for the assistance from REA.

PRIVATE FINANCING

Senator COCHRAN. There is a suggestion that if you do start cutting back in any way, you are going to jeopardize the entire program and private lenders will not furnish financing. What is your reaction to that? Is there a gap that would be created between need and access to financing?

Mr. HUNTER. Of course, we recognize this in the proposal. We provide for a couple of years for an adjustment to be made, for borrowers who have looked to REA for their money to be able to get acquainted with a private lender and become familiar with the process.

The other thing is—and this is very important, as I see it—that currently the borrower is going to the private sector for 30 percent of his money. In most cases, he went to C.F.C., the cooperative-owned lending institution, which is highly respected on the Hill, and on Wall Street. They have the capability to take mixed portfolios from those loans that they have made to REA borrowers and go to Wall Street and finance new loans and find their money. So we already know that procedure exists.

We know that the banks for cooperatives call on us almost every day, some bank or cooperative, wanting to get a better piece of the action in making loans to REA borrowers. We have people from Wall Street, we have people from major lenders, big and small, across the country, who approach us and talk to us very seriously.

They look at the aspect of being able to make a loan that is partly guaranteed, which gives them assurance, backed by a revenue flow, that is almost impregnable, as being a very appropriate place to lend some money.

I think we all know that the money is out there. So often, in the difficulties of an economy like we have now, one of the situations that a banker faces is that he cannot find a place to make a good loan, a safe loan. In most cases, bankers will consider that a loan to an REA borrower is a good loan, and he is anxious to find some of those.

PREPAYMENT OF LOANS

Senator COCHRAN. One way of creating some budgetary savings that has been discovered and used by this committee and the Congress is the paying off of existing debt that carries high rates of interest. What is your reaction to the proposal that may be a part of the next supplemental that is coming over from the House of Representatives to accelerate the payment of existing indebtedness owed by REA borrowers, or permitting and authorizing it as a way of generating access to new leeway in the budget for other spending programs?

Mr. HUNTER. Certainly, we have been very pleased that the decisionmakers in the Congress, along with the administration, looked at it, and came to the conclusion that they needed to change an agreement which once had been made. The fee for the refinancing would be withheld and would not be used and we would address the ability to refinance to those borrowers with the greatest need. That would assist some of these big generating plants that are in real trouble.

Someone may say, well, it is their fault anyway. The answer to that is that nobody was in a position to anticipate how much the economy was going to change and how much need there was going to be for some type of relief for those people who borrowed money at a very high rate and were faced with the inability to make payments on their loans.

So we see the merit in that program. I think it needs to have certain controls in it in order to make it fit the needs that do exist. We recognize that there is some benefit to the federal government as these payments are made. We have to recognize there is also some loss as that arrangement is pursued. I would like to provide additional information for the record.

[The information follows:]

Congress directed that $2,017,500,000 of FFB loans be refinanced during 1987 and that refinancing be directed to those G&T's having the greatest need. REA intends to accomplish this as directed. An expanded refinancing of all FFB loans is a different matter and would need to be reviewed by the Agency.

LOAN ASSET SALES

Ms. LAWRENCE. Senator Cochran, may I address that question?

Senator COCHRAN. Ms. Lawrence.

Ms. LAWRENCE. The history of the administration's proposal to sell assets did not stem from an attempt to help make the budget marks. It turned out to become that, but that was not what was intended when the first pilot asset sale was recommended by the Office of Management and Budget.

There were a lot of other goals to asset sales that had nothing to do with making the budget marks. Of course, as we can see from recent years, once the asset sale concept became accepted, it began to grow to do that.

But we all need to keep in mind, and certainly we in the executive branch need to keep in mind as we talk about asset sales, that it does solve our problem in the year of the sale but it does not solve the problem for income 5 years down the road when we lose the stream of income.

That is something I think both sides need to look at as we consider asset sales.

The goals of the asset sale program included a lot of other things like better documentation of loans, improved accounting methods, transferring some of the servicing to the private sector where it could be done cheaper. And making the budget mark was just one part of that.

Senator COCHRAN. I was wondering what your reaction would be. I do not know that it jeopardizes or endangers the programs or the ability to get the votes to continue the support of the REA programs. I do not know what impact it would have on that. I am not suggesting there would be any impact. However, the REA programs are becoming a target for the generation of funds to be used to pay for other programs. I do not know whether that is good or bad for REA. I am not sure it is all that good for REA. It may not have any effect.

It does concern me somewhat that the funds that are being generated are not being generated for REA. They are not benefiting the REA borrowers in the long run, but they are benefiting directly and immediately the beneficiaries of other government programs which might not be funded were it not for the taking of these resources from the REA programs.

I think we need to think about that and at least consider it. Somebody needs to study the long-term implications for the REA programs before we get carried away and concentrate on generating a lot of money out of the program and then may not be able to get the votes to continue to support the REA programs.

What I want to be sure that we do is to provide adequate funding for the REA programs in order to continue to maintain and expand service into areas where it is needed. I know from personal knowledge that in my state we have a lot of areas that could not afford electricity or telephone service without REA programs. So I am going to continue to be a very strong advocate for and supporter of the REA programs.

But I do want to be sure, and I recognize the need to ensure, that we not have the program abused by some areas of the country or some borrowers who could get along just as well without it. I think we need to take a new look at that problem that has been raised in the testimony this morning. It is not the first time that it has been raised.

It may be time to try to take a fresh look at how we get at that problem without hurting those borrowers that I am talking about in my state and Iowa and North Dakota and other states where there is a continuing and legitimate need for REA programs. That is what I want to be sure that we protect.

Mr. HUNTER. Senator, I particularly appreciate those remarks because this is one of the greater thrusts within this budget proposal, is to separate or analyze who really needs, who is serving the hard-pressed areas, who is serving those areas that are difficult to serve, give them a greater amount of the support and diminish the support for those that have a stronger natural situation to deal with.

I would like to comment on one more thing. I certainly appreciate the point that the Under Secretary made, because quite often we get all wrapped up in the immediacy of a situation and say, well, we are getting some government money back into the government and hallelujah, that is great, and we forget about what it might mean 10 years from now or 5 years from now or whenever. So I think we need to look at that.

Another thing, we talk about refinancing, and we sometimes forget about a program we call prepayment, whereby we go to our distribution borrowers or to our telephone borrowers. In this case, we did not go to them; they came to us. They said we are tired of being tied to the federal government. Those borrowers say we are ready to operate without REA financing if we could get a logical arrangement made to pay off the financing and to be without the various types of restrictions that you, as the lender, put upon us.

So we looked at that, and recognized the present value of $1 million is worth more today than it will be 20 years from now. We will allow the borrower to pay off the loan based upon the present value of money. It is less than the face value, yes.

We have had three borrowers now that have come to us and paid off every loan they owed to REA. The payoff was made on the present value of those dollars and cents that they owed us. So the government did not suffer a loss. They got less than the face value, but it got the funds immediately. They handed us a check the day they signed, and the funds went into the Treasury.

So this is another aspect of adjustments and differences that says two or three things. One thing it says is that there is money available in the private sector. These folks paid us off, and they went right to the private sector and replaced REA loans with loans from the private sector. So the money is there.

It also says that these folks have developed the management that you spoke of, Senator Stennis, the technological capability where they do not need REA holding their hand any more. So we see this as developing into a very effective way to deal with borrowers.

Senator COCHRAN. Thank you. Thank you, Mr. Chairman.

PREPAYMENT

Senator BURDICK. Mr. Hunter, I am very interested in what you just said. You remember when I put an amendment on the floor of the Senate to require prepayment, and you all fought it with a small exception?

Mr. HUNTER. Sir, there were some exceptions because part of us have felt that it was very good. But I would agree. You made a point, though, that I think I will have to endorse 100 percent, and that was that the Congress supported, Congress saw the need for that change, a new approach, different than we had ever had before, and did a wonderful thing for our borrowers and certainly did not hurt the federal government.

Senator BURDICK. But the administration came in and fought me.

Mr. HUNTER. I think they did at first when they did not understand the picture.

Senator BURDICK. Yes; they did. Have they changed their minds?

Mr. HUNTER. Yes, sir; it is in their budget right here.

Senator BURDICK. Think about that.

Mr. HUNTER. You have been very convincing, Mr. Chairman. Maybe that is why they changed their minds.

Senator BURDICK. The Senator from Iowa.

SENATOR HARKIN'S REMARKS

Senator HARKIN. I really do not have any questions, Mr. Chairman, other than just to say that I think that to the extent that we can perhaps tighten down on REA loans in, as you say, highly urbanized areas, suburban areas, recreation areas, things like that. To a certain extent that might be all right as long as it does not harm the portfolio of loans that the whole REA system has out there.

I want to concur with what the Senator from Mississippi just said a little bit ago. We have areas of Iowa right now, I am sure just as he has in his own state, that if we did not have the REA system out there, people just could not afford to pay the kind of market rates that perhaps are anticipated in trying to move this out of the subsidized-loan arrangement into a marketplace type of system.

I do not see any support here in Congress to do that, either. I am all for tightening down on the system and things like that to make sure that it meets its original goals of providing service to people in rural areas and small communities. I see nothing wrong with them also meeting the goal of trying to expand business opportunities in small towns and communities. There is nothing wrong with that. It does not have to be strictly on the farm. To that extent, we ought to continue whatever support we can for the system.

I do not have any questions, Mr. Chairman.

Senator STENNIS. Mr. Chairman, may I request the privilege of filing questions for the record?

Senator BURDICK. That privilege will be granted to all members of the committee who have questions.

Senator STENNIS. Thank you very much.

REIMBURSEMENT TO REVOLVING FUND

Senator BURDICK. I have one or two more questions, Mr. Hunter, and will let you go back to your office.

How can you talk about subsidies to the borrowers in one breath, and then you say in the next breath that the government is not losing any money? I am talking about the subsidy that we are giving REA borrowers because of the interest rate and that you want to increase the interest rate. I am talking about the same thing we were talking about a minute ago.

In your statement, you indicate that you are not requesting any reimbursement to the revolving fund because it has not sustained any losses since its inception. You said that it was a good program and you have not sustained any losses.

How can you say it is a bad program, then?

Mr. HUNTER. Mr. Chairman, one of the things we need to remember is that that revolving fund had an amazing gift. It had a gift from the

Congress and I do not question that. I think that was needed in order to help the revolving fund get started.

The fact that $7.9 billion was dedicated to the REA revolving fund, interest free, kept the fund from suffering losses. When you start with a $7.9 billion capitalization and do not have to pay any interest, that takes care of a lot of costs and difficulties.

So this is a pertinent part of the reason for that answer, sir.

LOAN ORIGINATION FEE

Senator BURDICK. I heard a suggestion that the loan-origination fee to fund the salaries and expenses of Rural Electrification would be put into effect under the new system. Is that correct?

Mr. HUNTER. That is right.

Senator BURDICK. How much would this fee be?

Mr. HUNTER. It amounts to, under the budget we anticipate, $27 million-plus to cover our salaries and expenses for the 1988 fiscal year. Those origination fees would be levied, depending upon what the anticipation is of the need, at a level of not above 3 percent, probably.

The collection of that origination fee would be at the time the loan was made, which means that nobody would be making that support for the activities of this agency except those who are currently receiving benefits, in other words, receiving loans and receiving money from REA.

Senator BURDICK. I found one more question.

LIEN ACCOMMODATION

Mr. HUNTER. I have a correction too, Mr. Chairman. Maybe this would be a good time to make it. That is that we talked about lien accommodations and we talked about subordination at one time. Really, the thing that we have practiced and would continue to practice is to share a lien accommodation with the lenders from the private sector, which would mean that they would have access and we would have access to the security that exists on an even basis.

Senator BURDICK. Wait a minute. Sharing the lien is not the same as subrogation.

Mr. HUNTER. That is right. That is what I wanted to correct.

Senator BURDICK. You want to amend your answer you gave to my question some time ago that you do not subrogate the loan.

Mr. HUNTER. That is right. It is lien accommodation.

REFINANCING

Senator BURDICK. Last year, I was the chief sponsor of an amendment to the supplemental appropriation bill which provided for the prepayment of REA-guaranteed Federal Financing Bank loans that we have been talking about. The amendment provided cooperatives with the opportunity to refinance debt and reduce interest costs.

This amendment was designed to help already hard-pressed rural electric consumers. Rural people are hurting, so the amendment was good news to cooperatives trying to hold the line on rates.

Then in the reconciliation bill, Congress adopted language after concluding an agreement with the Administration late last year, which provided for some refinancing, about $2 billion. Included as a part of that agreement between the Administration and the Congress was an assurance by the Administration that cooperatives serving low-density, high-cost service areas, such as those with three customers per mile of line or less, would be eligible to refinance.

Now it has come to my attention that the rules developed by REA do not include amongst the criteria the density factor. This precludes many co-ops, that are doing their best to keep electric rates as low as possible during these desperate economic times, from refinancing and getting the benefit of this amendment for the member-consumers. Since I was the original author of this amendment, I find that very upsetting.

I would like you to explain to me why the density criteria were not included in the regulations when the Administration made an agreement to do so.

Mr. HUNTER. Your question is well taken. The determination of what criteria were to be followed by REA in refinancing was, I know, argued and discussed at length, and a decision was finally made by the Administration and by the Congress. We have accepted that. We had some input into it. But it was made, as it usually is and should be, by those in control. And the decision did not include all of the items which might have some impact.

I think we read into this, though, REA reads into it, that it is very important for us to look at the needs of borrowers who qualify for refinancing. We have tried to do that. I think we have. But again, we are tied to legislative language, and that is what we are following, sir.

Senator BURDICK. It was ignoring the clear intent of Congress, was it not?

Mr. HUNTER. Are we ignoring it?

Senator BURDICK. In this regard you did.

Mr. HUNTER. I do not believe so, sir.

Senator BURDICK. On the density factor.

Mr. HUNTER. The process that we followed, which of course you know very well, was to develop regulations that expressed specifically how and what we would consider as we authorize the refinancing. And I do not believe that we have avoided the position of Congress on that. Of course, the regulation process, where it was posed before the public, should have exposed anything that we might have overlooked. But I do not think we did, sir.

Senator BURDICK. I do not have the congressional language before me. But I remember we put in this density factor, the language that was adopted on the floor.

Mr. HUNTER. Mr. Chairman, may I comment further on that?

Senator BURDICK. Yes.

Mr. HUNTER. There are certain things finally determined in the legislative process, and there is also a colloquy on the floor which expresses the intent and the desire of Congress. I think they need to be taken into consideration, but maybe they were never included within the legislation that was passed. I am wondering if we might be mixing a little of that, because I know we have studied the colloquy and have looked at that as being guidance and have tried not to violate that. But it never was included in the legislative requirements that were given to us.

Could we provide to you a letter addressing any questions that you might have? And maybe you will provide us a question that would help us arrive at this.

Senator BURDICK. I would be glad to send a letter and make it part of the record, if you so desire.

But while we are on this subject, for more clarity, I would also like to have this letter made part of the record. This is a letter from Charles O. Sethness, Department of the Treasury, to Senator Abdnor.

It reads:

> It is our understanding that enactment of the language on refinancing of REA-guaranteed loans held by the Federal Financing Bank contained in the budget reconciliation bill would provide the Administrator of REA with the authority to allow him to establish through regulations, eligibility criteria to permit cooperatives with an average customer density of three or fewer per mile to prepay their high-rate borrowings from the Federal Financing Bank at par. We also understand that the Basin Electric Power Cooperative would be eligible under such a criterion.
>
> I hope this information is helpful, and would be pleased to discuss the matter further with you at your convenience.

Senator BURDICK. In other words, you had the authority, according to the Department of the Treasury, to make density one of those factors.

Mr. HUNTER. I have a couple of things. One of the things is that as you read the letter he states that the REA would have the authority; that is, it is optional to some degree.

In following that up, it seems to us, as we developed the regulation, that those types of items or bases for criteria that you referred to in your question and your interest are addressed or covered, perhaps not by name precisely but by the effect of what we look at. In other words, we look at the question of what rates are doing. We look at the question of other types of indicators of hardship as we make the determination of who we will approve and who we do not.

So I think we are reaching the same result, but perhaps we are not reaching it through the statement of the very word that you made reference to.

Senator BURDICK. I have a statement from Senator James Sasser to be made a part of the record at this point.

[The statement follows:]

STATEMENT OF SENATOR SASSER

Thank you, Mr. Chairman.

The Rural Electrification Administration has been and continues to be of critical importance to the development of rural America. Since REA was established in 1935, electric power has been brought to virtually all areas of this country. The extension of electrical service meant not only the comforts of modern appliances, it meant business expansion and economic development. It has meant the continued vitality of rural America.

In my own state of Tennessee, there is currently $282,043,000 in outstanding loans. Those loans cover 201,347 subscribers in rural Tennessee. The work of REA is not finished in Tennessee. There is certainly a continuing need for a strong and vital Rural Electrification Administration.

So I take issue with the administration's contention that we no longer need REA. We cannot rest on our laurels or we will find the lights going out over rural America. The administration's policies, and the President's budget, are shortsighted and destructive of what we have accomplished in bringing electric and telephone service to the rural sections of our country.

For instance, Administrator Hunter's testimony states that REA's "mission as a federal credit agency to provide funds for quality electric and telephone services to rural America is almost accomplished." But it ignores a simple fact—utilities are not frozen in time. They require upkeep, maintenance, and modernization. We must not only provide electric and telephone service now, but also in the future.

Many electric and telephone cooperatives have old and outdated equipment. Within a very few years they face significant replacement and modernization costs. We must ensure that strong and effective REA programs are available to rural utilities to finance these improvements.

Despite the administration's claims, the plain fact is that private loan sources are not available to most REA borrowers. REA borrowers have an average ratio of net worth to total assets of 30 percent—far below the 50 to 60 percent required by commercial lenders. Without the programs of the Rural Electrification Administration, rural utilities will be unable to meet customer needs in the future.

The simple fact is that providing utility service to high-cost rural areas is uneconomical. REA borrowers serve an average of five customers per square mile, compared with 50 for all telephone companies, and about 130 for the Bell companies. The administration's claim that REA service goes to many nonrural areas is based on a customers-per-mile formula that is virtually pulled out of a hat. By any common standard in the industry, the vast number of REA borrowers are truly rural.

Additionally, I am disturbed by REA's continued insistence on phasing out the Office of Engineering Standards despite the clearly expressed views of Members of both the Senate and House. Since 1984, 6 of its 23 employees have left the office and another 4 will leave by the end of 1987. Only one of these positions has been filled. The elimination of this office will place a serious burden on the ability of utilities to install equipment which meets adequate engineering standards.

Most importantly, underlying the administration's budget and testimony is the assumption that REA can be eliminated as all but a token agency. The administration's fiscal year 1988 budget proposes to eliminate the direct loan program, the 100 percent REA guaranteed loans, and all support to the Rural Telephone Bank. They propose to replace them with private loans backed by REA under severely restricted eligibility rules. In the past, Congress has opposed less drastic attempts to destroy REA and I am confident we will do so again.

SUBMITTED QUESTIONS

Senator BURDICK. I have additional questions to be submitted for the record, and they are going to be from Senators Burdick, Bumpers, Sasser, Grassley and Stennis. I trust that you will answer them as soon as possible.

Mr. HUNTER. We will be glad to, sir.

[The following questions were not asked at the hearing but were submitted for response for the record:]

QUESTIONS SUBMITTED BY SENATOR BURDICK

GENERAL

Question: Mr. Hunter, last year, I was the chief sponsor of an amendment to the supplemental appropriations bill which provided for prepayment of REA guaranteed Federal Financing Bank (FFB) Loans. The amendment provided cooperatives with the opportunity to refinance some debt and reduce interest costs. This amendment was designed to help already hard-pressed rural electric consumers. Rural people are hurting, so the amendment was good news to cooperatives trying to hold the line on rates.

Then, in the Reconciliation Bill, Congress adopted language after concluding an agreement with the Administration late last year, which provided for some refinancing, about $2 billion. Included as part of that agreement between the Administration and the Congress, was an assurance by the Administration that cooperatives serving low-density, high-cost service areas such as those with 3 consumers per mile of line or less, would be eligible to refinance.

Now, it has come to my attention, that the rules developed by REA do not include amongst the criteria, the density factor. This precludes many co-ops, who are doing their best to keep electric rates as low as possible during these desperate economic times, from refinancing and getting the benefit of this amendment for the member-consumers. Since I was the original author of this amendment, I find that very upsetting.

I would like you to explain to me why the density criteria were not included in the regulations when the Administration made an agreement to do so.

Answer: REA published its final rule governing the FFB refinancing program on January 14, 1987, in the Federal Register. This rule (7 CRF 1786) was initially published in draft form on November 26, 1986, and many comments on suggested criteria for determining eligibility were received. After careful review of all comments, the following basic criteria for eligibility were set forth in the final CFR.

--The borrower's financial condition is such that the borrower will not be able to meet the financial tests set forth in its mortgage.

--The borrower is in default or near default on interest or principal payments due on loans made or guaranteed by REA, and is making a good faith effort to reduce rates and reduce costs to avoid the default.

--The borrower is participating in a workout plan or debt restructuring plan with REA.

--The borrower received the approval of the Secretary of the Treasury to prepay FFB loans pursuant to the "interim regulations governing prepayments of loans made by the Federal Financing Bank and guaranteed by the Rural Electrification Administration".

Although these rules are general, they clearly attempt to provide refinancing authority to borrowers experiencing the greatest need. It was REA's judgment that density should not be used as the sole criteria in determining a borrower's eligibility for refinancing since many other factors also contribute. Density is a part of the economic situation confronting a borrower, and it is being considered in REA's determination of borrowers in greatest need.

Question: Why did the Administration choose to ignore the intent of Congress and the law and break its agreement with Congress?

Answer: REA does not believe it has ignored the intent of Congress or broken any agreement with Congress in developing the eligibility criteria. While low density may contribute adversely to a borrower's economic wellbeing, REA believes that it should not be the sole criteria for determining eligibility.

REA believed that Congress desired the refinancing to be directed to the borrowers in greatest need and the criteria for refinancing is directed to those borrowers.

TRANSFERRING BORROWERS TO THE PRIVATE SECTOR

Question: Mrs. Lawrence, I note with great interest, some of the statements in your opening remarks. You indicate that your proposal recognizes the financial strength of REA borrowers and you suggest that you are proposing to guide REA programs in a new direction which will reduce the electric and telephone borrowers' dependence upon the Federal Government.

Well, as you know, last year I had an amendment which would allow exactly the same thing and you did not support it. I simply tried to get some of these borrowers into the private capital market and away from the Federal Government and you said, "No, we do not want it." How can you support your proposal, when you did not support mine?

Answer: When REA refers to reducing borrowers' dependence on the Federal Government, we are referring to revolving fund borrowers prepaying their loans and obtaining financing from the private sector.

The budget proposal will provide for continuation of REA/FFB refinancing. The major difference between this proposal and the existing refinancing amendment is that our proposal does not carry a 100 percent guarantee, thus relieving the taxpayers of a large amount of contingent liability.

Question: Another statement that I find absolutely mind-boggling, is that this Administration is proposing to sell some of these loans on a non-recourse basis. Obviously, you are going to have to discount these loans in order to sell them, otherwise you are just not going to get rid of them. I cannot understand why you would be in favor of selling these loans at a discount to Wall Street, so that somebody on Wall Street can make money, instead of letting the borrowers of the loans themselves pay them back 100 cents on the dollar. What is your explanation for such cockeyed reasoning?

Answer: I would like to point out that the proposed legislation would also allow REA borrowers to repay their direct loans at a discount. Loans that are not prepaid will be considered for sale and the revenue received from these sales will allow REA to repay Treasury borrowings and repurchase Class A Stock of the Rural Telephone Bank. Loan asset sales will allow early retirement of Agency debt and assist in meeting deficit targets enacted by Congress.

REIMBURSEMENTS TO THE REVOLVING FUND

Question: Mr. Hunter, in your statement you indicate that you are not requesting any reimbursement to the revolving fund because it has not sustained any losses since its inception. At the same time, you talk about this terrible subsidy that we are giving REA borrowers because of the interest rate and that you want to increase the interest rate in order to eliminate the subsidy.

How can you, out of one side of your mouth, talk about a subsidy to the borrowers, and from the other side of the mouth, say the government isn't losing any money?

Answer: A subsidy to borrowers is realized whenever the interest rate charged to the borrower is less than the cost-of-money to the government. The fund has not sustained any losses since its inception in 1973 because it is exempted from paying annual interest costs to the Treasury on advances totaling $7.9 billion. The amount of interest that would have been payable in 1986 was $307 million. The revolving fund is not reflecting a loss because annual interest costs on the initial money used to establish the fund were forgiven.

Question: At this point, could you please provide for the record, the current status of the Rural Electric and Telephone Revolving Fund (RETRF)?

Answer: The following table shows the status of the RETRF as of September 30, 1986.

RETRF

Assets	$11,740,084,073
Liabilities	8,815,123,999
Equity	2,924,960,074

Question: Recently I wrote to you Mr. Hunter and asked you for information on the amount of defaults on loans. You responded to me on March 13, and at this point in the record, I would like to enter your response.

(The letter follows:)

LETTER FROM HAROLD V. HUNTER

Honorable Quentin N. Burdick
Chairman, Subcommittee on Agriculture,
  Rural Development and Related Agencies
United States Senate
Washington, D. C. 20510-6025

MAR 13 1987

Dear Mr. Chairman:

Pursuant to your letter of February 24, 1987, regarding loan defaults of Rural Electrification Administration (REA) borrowers, the following data is provided for your information:

1. Defaults and Payment Amounts

A. The total amount of loan defaults which has occurred in each of REA's loan programs -- insured and guaranteed -- during fiscal years 1985 and 1986:

LOAN DEFAULTS
(x $1,000)

LOAN PROGRAMS	FY 1985	FY 1986
Insured	6,188	8,659
Guaranteed	164,028	163,647

B. Of the default amounts listed above, the Rural Electrification and Telephone Revolving Fund (RETRF) was required to pay to the Federal Financing Bank (FFB) and other lenders the following:

RETRF PAYMENTS ON DEFAULTS
(x $1,000)

CREDITORS	FY 1985	FY 1986
FFB	164,028	163,647
Other Lenders	-0-	-0-

C. (1) The net amount of defaults during fiscal years 1985 and 1986 for each of REA's loan programs -- insured and guaranteed:

BORROWERS IN DEFAULT
(x $1,000)

	FY 1985		FY 1986	
	Guaranteed	Insured	Guaranteed	Insured
WIPCO (Illinois 51)	-0-	-0-	4,854	-0-
Wabash (Indiana 107)	64,341	-0-	48,837	-0-
Sunflower (Kansas 53)	11,316	-0-	26,672	2,631
Big Rivers (Kentucky 62)	88,371	6,188	60,832	4,643
Wolverine (Michigan 46)	-0-	-0-	20,280	-0-
VEC (Vermont 7)	-0-	-0-	-0-	748
VEG&T (Vermont 12)	-0-	-0-	2,172	637
	164,028	6,188	163,647	8,659

(2) The total amounts of payments, both principal and interest, made by the borrowers in fiscal years 1985 and 1986 on loans provided through each of the REA's loan programs -- insured and guaranteed:

PAYMENTS BY BORROWERS IN DEFAULT
(x $1,000)

	FY 1985		FY 1986	
	Guaranteed	Insured	Guaranteed	Insured
WIPCO (Illinois 51)	45,860	1,651	37,591	1,673
Wabash (Indiana 107)	17,135	-0-	12,760	-0-
Sunflower (Kansas 53)	83,789	3,487	15,236	877
Big Rivers (Kentucky 62)	38,395	-0-	44,357	1,548
Wolverine (Michigan 46)	104,762	3,657	67,324	3,724
VEC (Vermont 7)	-0-	-0-	-0-	-0-
VEG&T (Vermont 12)	2,792	805	734	209
	292,733	9,600	178,002	8,031

2. Underlying Causes

Western Illinois Power Cooperative (WIPCO - Illinois 51) is the wholesale supplier for seven member distribution cooperatives which provide services to approximately 44,000 consumers. WIPCO is experiencing member unrest and financial distress due primarily to its participation in the Clinton Nuclear Station (Clinton). Clinton, a 950 MW nuclear unit, is currently scheduled for commercial operation in early 1987. It has been estimated that when Clinton is in-service, WIPCO retail rates for member systems will be 80 percent higher than neighboring investor-owned utilities. With continued consumer unrest, there is concern that consumer loads may erode and compound the problem of high rates.

For the past year, REA has been working with Soyland Power Cooperative, Inc. (Illinois 53) and WIPCO on developing a solution. WIPCO has been pooling its operations, personnel, and other costs, along with power supply facilities, with Soyland Power Cooperative, Inc.

We estimate the negotiations with Soyland and WIPCO will be complete by the end of March. If there is sufficient load growth, the Government will eventually be fully repaid.

Wabash Valley Power Association, Inc. (Wabash Valley - Indiana 107), on May 23, 1985, filed a Petition for Reorganization under Chapter 11 of the Federal Bankruptcy Code with the United States Bankruptcy Court. The filing resulted from Wabash Valley's nonpayment of approximately $525 million borrowed from FFB under the REA guaranteed and insured loan programs, for its investment in the cancelled Marble Hill Nuclear project. Wabash Valley contends that Indiana law does not allow utilities to collect revenues from ratepayers for generating plants under construction.

REA and Wabash Valley are negotiating and awaiting the Bankruptcy Court's decision. Valuation hearings by the court are scheduled to commence in March 1987. The estimated cost to the Government will depend on the negotiation and the Court decision. The Government is asking the court for full payment.

Sunflower Electric Cooperative, Inc. (Sunflower - Kansas 53), is a generation and transmission cooperative made up of eight distribution members currently supplying power and energy to approximately 44,000 rural consumers located in the western one-third of the State of Kansas. In the late 1970's, Sunflower forecasted generation capacity deficiency in the 1980's and 1990's. Based on engineering, economic and environmental considerations, decisions were made to build Holcomb, a coal-fired generating plant, rated at 280 MW net capability with a 316 MW nameplate rating. Sunflower utilized FFB, REA, Pollution Control Bonds and Safe Harbor Lease tax benefits to finance Holcomb and its related transmission facility. During and after the construction of Holcomb, Sunflower faced serious cashflow problems and defaulted on all debt services. This was caused by the following factors: lower than anticipated load growth, less than expected rate increases allowed by the Kansas Corporation Commission (KCC), the inability of Sunflower to sell excess capacity, to reach lease back agreement, or to sell Holcomb.

After months of negotiations, all the creditors agreed upon a workout plan. REA believes that the potential for recovery under the workout plan is better than forcing Sunflower into bankruptcy or a sale of Sunflower's assets.

The workout plan basically involves the write-down of FFB interest rate from 10.25 percent to 9.5 percent and provides for three classes of notes, A, B, and C. Note "A" can be serviced from the current cashflow, Note "B" will be paid from incremental increases in Sunflower's available cashflow over and above anticipated 1986 available cashflow, and Note "C" will be paid after all "B" notes are paid off. REA is hopeful that it will obtain recovery under the "C" note. If it does not obtain such recovery, the estimated cost to the Government will be approximately $60 million -- the write-down of FFB interest rate and the "forgiveness" of "C" notes.

The workout plan is at the final stages and the Government is hopeful that the plan will be fully implemented in the next several months.

Big Rivers Electric Corporation (Big Rivers - Kentucky 62) is the wholesale supplier for four distribution cooperatives in western Kentucky servicing 71,000 consumers. Two of its distribution cooperatives each service a large aluminum smelter. In the late 1970's, in anticipation of a continuing healthy rural and industrial load growth and the continuing need by the smelters for high system reliability, Big Rivers decided to add generation to the existing generating and transmission system. Due to the smelters now saying that they can accept lower system reliability and less than expected rural and industrial load growth, Big Rivers has surplus capacity. Because of low aluminum prices, the two aluminum companies claim that they will have to close the plants in Kentucky if Big Rivers raises its wholesale prices. Big Rivers would be extremely concerned if this happened. Because the two companies account for over 60 percent of Big Rivers' load, closing any of the smelters would cause a dramatic increase in the rates to the other 71,000 consumers, causing the loss of thousand of jobs and impacting Big Rivers' ability to pay its debts to REA and FFB. Currently, Big Rivers is aggressively selling its surplus power to other cooperatives or utilities. A rate case is before the Kentucky Public Service Commission, and a ruling is expected in March. REA is working closely with other creditors, and Big Rivers to restructure their debt service schedule. Depending on the degree of energy sales, and the cashflow situation, hopefully, the only cost to the Government will be the deferral of payments and the lowering of the contracted interest rate to 8 percent.

Wolverine Power Supply Cooperative, Inc. (Wolverine - Michigan 46), entered into a participation agreement with Detroit Edison to construct Fermi II Generating Station in 1977. With numerous cost overruns and delays of operation of Fermi II, Wolverine and Detroit Edison tentatively agreed to dissolve Wolverine's interest in Fermi II by Detroit Edison assuming Wolverine's Fermi-related FFB debt service less $200 million by March 31, 1987. Wolverine's members have threatened bankruptcy action if REA does not participate in restructuring the $200 million debt. Negotiations on this matter are ongoing. It is too early in the negotiations to estimate any future loss to the Government but it is hoped that future load growth could minimize or eliminate any loss.

Vermont Electric Generation & Transmission Cooperative, Inc. (VEG&T - Vermont 12), has over the past few years committed itself to purchase a surplus of high-cost energy. The market for electricity in the northeastern United States is depressed at present and Canadian hydroelectric power is being introduced on the market at very low rates. VEG&T has had to sell some of its power to utilities at lower than cost rates.

Vermont Electric Cooperative, Inc. (VEC - Vermont 7), is the distribution utility of VEG&T. Having to shoulder the load of high power costs has necessitated recent rate increases and caused customer unrest. Both VEG&T and VEC are heavily indebted to REA, FFB, and the National Utilities Cooperative Finance Corporation (CFC). No principal or interest payments on these borrowers' long-term debts have been made since March 1986. REA has been actively assisting VEC/VEG&T to find a workable solution to their financial difficulties. We recognize that VEG&T's surplus of energy, if sold at market prices, can contribute significantly to the cooperatives' ability to meet their debt obligations while holding electric rates at an acceptable level. REA has initiated negotiations with another REA borrower in New Hampshire, with the objective of selling off VEG&T's excess electricity. The Vermont cooperatives, the New Hampshire cooperative, REA, FFB, CFC, and respective legal counsel and consultants are working concurrently to attain a solution by May 1987. Negotiations have not yet progressed to a point where it is possible to quantify any loss to the Government.

3. Future Problem

At present, REA is closely monitoring all generation and transmission (G&T) systems' operations and analyzing their financial data in order to identify potential problem borrowers. With the Burdick amendment, the qualified and the needier G&T's can moderate their interest expenses by seeking private lenders to refinance the high-cost portions of their debts. REA is working diligently to keep the Government's possible loss to a minimum.

If we can be of further assistance, please let us know.

Sincerely,

Harold V. Hunter

HAROLD V. HUNTER
Administrator

Question (continued): In that response, you indicate that for both fiscal year 1985 and 1986, approximately $164 million was paid by the Rural Electric and Telephone Revolving Fund to the Federal Financing Bank.

Could you tell me if you have any defaults at this point in fiscal year 1987?

Answer: For FY 1987, through March 31, the net amount of payments REA has made to FFB, on behalf of borrowers whose loans are guaranteed, is $124,052,317.70.

Question: Could you please provide for the record the amount of money going into the Rural Electric and Telephone Revolving Fund (RETRF), as well as the amount leaving the fund for fiscal years 1985 and 1986? Please delineate what types of payments these are.

Answer: The following table reflects the cash flow of the RETRF for fiscal years 1985 and 1986.

RETRF
(Dollars in Millions)

	1985	1986
Receipts		
Interest	$510.8	$539.1
Principal	440.1	427.8
CBO Sales	378.6	617.4
Appropriation	216.0	99.4
FFB Collections	3,545.6	3,682.5
Disbursements		
Advances	797.1	960.9
Interest Expense	408.9	438.0
CBO Repurchases	191.0	100.5
Payments to FFB	3,742.0	3,814.4

Question: Certainly, the payments on defaults represent losses to the revolving fund, do they not?

Answer: Payments made by REA for defaults on loans made by the Federal Financing Bank (FFB) are disbursements of the revolving fund. However, there is the potential for recovery of the funds. REA will be working with each borrower and its creditors to restructure their debt and allow them to continue making payments to the Government.

SALARIES AND EXPENSES

Question: You propose a loan origination fee to fund the Salaries and Expenses of the Rural Electrification Administration. How much would this fee be?

Answer: The loan origination fee in the 1988 budget proposal to fund Salaries and Expenses of REA is approximately 2.3 percent.

Question: Given your proposal to reduce the loan levels, wouldn't the fee have to continually increase or else the fund for Salaries and Expenses would continue to decrease?

Answer: The legislation will propose to charge a loan origination fee on all new loans, including privately originated loans guaranteed by REA. The revenue from these sources will be adequate to fund REA's administrative costs.

Question: Is the idea that you would get rid of all REA staff because you wouldn't have any loans to make?

Answer: The FY 1988 budget proposal includes 500 staff years which will allow processing of loans at the requested levels and to service the outstanding loan portfolio. We are not proposing a reduction-in-force or other elimination of REA staff except by normal turnover.

Question: How would you then service the existing loans?

Answer: REA's servicing responsibilities would be reduced to some extent because private lenders would have the primary responsibility for servicing the loans they make with REA's guarantees. REA would service existing loans within the 500 staff-year level proposed in the budget. The 1988 budget proposal projects a loan level of approximately $1.4 billion annually through 1992. An REA staff will be maintained to administer the proposed program.

PREPAYMENT OF GUARANTEED LOANS

Question: The 1987 Reconciliation Act requires the prepayment of $2.0175 billion in guaranteed loans. How much of the $2.0175 billion has been prepaid to date?

Answer: One borrower, Soyland Power Cooperative, has refinanced guaranteed loans of $281,795,430.

Question: Knowing that the Congress mandated this much prepayment in order to achieve $2.0175 billion in outlay savings to reduce the deficit by a like amount, why has so little of this been accomplished?

Answer: The regulation implementing Section 306A of the Rural Electrification Act, Prepayment of Loans, was published in final form on January 14, 1987 (FR 1434). The first refinancing was completed on March 19, 1987. We anticipate timely processing of future refinancing requests.

Each application for refinancing must be evaluated. An evaluation can be completed in approximately 30 days if all the necessary information is provided in the initial submission. The development of the refinancing documents for Soyland Power Cooperative took about 3 months, but faster processing of refinancing applications is anticipated.

Question: How many applications to prepay do you have on hand? In number and amount?

Answer: Refinancing has been approved for Soyland Power Cooperative, Inc., Decator, Illinois, in the amount of $281,795,430. As of April 9, 1987, the following 20 additional borrowers have applied to REA for refinancing of FFB debt.

Applications	Amount Proposed to be Refinanced
Alabama Electric (AL)	$124,064,516
Arizona Electric Power (AR)	49,727,003
Associated Electric (MO)	458,237,389
Basin Electric Power (N.D.)	190,459,862
Big Rivers Electric (KY)	578,667,971
Brazos Electric Power (TX)	88,334,697
Cajun Electric Power (LA)	1,078,402,491
Cooperative Power (MN)	69,457,222
Deseret Generation & Transmission (UT)	188,642,000
East Kentucky Power (KY)	325,692,974
Hoosier Energy Rural Electric (IN)	204,325,386
Kansas Electric Power (KS)	62,609,799
New Hampshire Electric (NH)	47,378,000
Pacific Northwest (OR)	17,420,000
Saluda River Electric (SC)	212,492,590
San Miguel Electric (TX)	297,115,276
Seminole Electric (FL)	329,260,000
Southern Illinois Power (IL)	55,383,360
Tex-La Electric (TX)	101,603,000
Western Farmers Electric (OK)	234,947,758
Total	$4,714,221,294

Question: When will you meet the required $2.0175 billion?

Answer: Currently, a refinancing of more than $1 billion is in process with a target of the middle of May for completion. The remaining funds to meet the $2.0175 billion level will be refinanced before the end of the fiscal year.

REPAYMENT OF INSURED LOANS

Question: How many of the cooperatives have bought back their insured loans at a discount. What dollar amounts?

Answer: To date, three borrowers have prepaid direct loans at a discount. The following table lists the borrowers and amount paid.

Borrower	Closing Date	Amount
Guadalupe Valley	12-31-86	$17,876,144
Deaf Smith	12-31-86	6,695,835
Southern Nebraska	3-09-87	15,105,210

Question: How many do you expect to buy back their loans?

Answer: At this time we do not know the number of borrowers or the amount of the loans that will be prepaid. However, we do expect to receive additional payments, based on the expressed interest of the borrowers.

Question: Why did REA work so hard to facilitate the buy-back of insured loans at a discount by issuing rules on December 30th and closing two buy-backs the same day?

Answer: Section 1011 of the Omnibus Budget Reconciliation Act of 1986 required that regulations implementing this section be issued within 60 days after the date of the Act, which was enacted on October 21, 1986. It was also important to the two borrowers that prepaid their loans on December 30, 1986, to complete the transaction in calendar year 1986.

Question: Why hasn't the agency worked as diligently to complete more FFB payments?

Answer: REA has worked as diligently to implement Section 306A of the RE Act, which relates to the prepayment of guaranteed loans, as it has to implement Section 306B, Sale or Prepayment of Direct or Insured Loans. Unlike the prepayment of insured loans which severs the relationship between the Government and the borrower, refinancing of FFB debt still carries with it a 100 percent REA guarantee. This continued Federal guarantee, and the dollar magnitude of a single transaction, makes the processing of a guaranteed refinancing much more complicated and time consuming than the prepayment of an insured loan.

Question: Why is the Administration opposed to the cooperatives prepaying FFB loans using private capital when in other cases like foreign military sales, the government permits borrowers to reduce interest payments while retaining FFB money?

Answer: The Administration is not opposed to cooperatives prepaying FFB loans using private capital in accordance with the terms in Section 306A, Prepayment of Loans, of the Omnibus Reconciliation Act of 1986.

Question: Would REA borrowers' prepayments be more acceptable if these prepayments were not with private capital?

Answer: The Administration has no objection to prepayment by borrowers using private capital.

PERIODIC OMB RESTRAINTS ON LENDING

Question: Can you explain to the Committee the practices of the Office of Management and Budget (OMB) setting quarterly or other periodic restraints or quotas on loan approvals for your office?

Answer: The Office of Management and Budget distributes or apportions amounts appropriated by Congress. The apportionment process is intended to prevent obligation of funds in a manner that would require deficiency or supplemental appropriations and to achieve the most economical use of funds. The Agency may request reapportionment of funds between quarters, if necessary.

Question: How does it work?

Answer: Agencies are responsible for initiating requests for apportionments and reapportionments through the Department of Agriculture to the Director, Office of Management and Budget (OMB). The request for apportionment of available funds is based on the projected needs of the loan programs. A provision is made for seasonal variations in funding levels. It is the responsibility of OMB to act upon the request and notify the Agency of the action taken. The budgetary resources of most federal agencies are apportioned by quarter.

Question: Are these restrictions in conflict with the range of annual levels set by Congress?

Answer: The apportionment process does not conflict with the annual levels established for REA's loan programs by the Congress.

Question: Who is responsible for setting these loan levels under the Statute?

Answer: The Congress is responsible for making appropriations and authorizing program levels.

Question: Don't these restrictions delay loan processing and approval?

Answer: The distribution of available funds by OMB does not delay the loan approval process. Apportionments are based on the Agency's request which has considered the funding requirements for each program.

Question: Haven't you been criticized already by GAO and this committee for burdensome and unnecessary time-consuming processing of loans?

Answer: The May 1986 General Accounting Office Report to the Chairman, Committee on Agriculture, Nutrition and Forestry, United States Senate, indicated an improvement in the average number of days it took to process an electric distribution loan application.

The following table, with the exclusion of fiscal year 1986, appeared in the report:

Electric Program

Fiscal Year	Average Number of Days
1983	207
1984	170
1985-1/	79
1986-2/	75

1/ Source: GAO
2/ Source: REA Statistics

There has also been substantial improvement in the time required to process a telephone loan. However, the loan processing time is determined primarily by the completeness and accuracy of the support data submitted by the applicant and the complexities of the loan purposes. Therefore, the processing cannot start until all the loan support data is received and, usually, it is many months before the applicant submits the engineering and cost data to support the loan application.

For comparison purposes, the following table shows the number of days to receive a completed application from the time of its initial submission and the time required to process the loan approval.

Telephone Program

Fiscal Year	Application Received to Application Completed	Application Completed to Loan Approved
1983-1/	277 days	401 days
1984-1/	257	386
1985-1/	320	240
1986-2/	279	186

1/ Source: GAO Report RCED-86-101, May 1986.
2/ Source: REA Statistics

LOAN PROCESSING REVIEW

Question: The Senate Report for fiscal year 1987 appropriations (99-438), commented on the cumbersome and time-consuming steps that must be taken in order to get a loan. In particular, we noted that it takes 79 days for an electric loan and 240 days for a telephone loan.

In that report, we said that REA should update and streamline its procedures.

Mr. Hunter, do you now have in place a system of staff accountability for evaluating the process of loan applications through the review and approval process?

Answer: The area offices are responsible for the review and processing of loan applications. REA has had a computerized tracking system in place for several years. The status of loan applications on hand indicates the processing time of each step from receipt of the application until the loan is approved.

Question: If not, I know REA in the past has had such a production report review process, why don't you have one now?

Answer: We do not have a production report review process, but we monitor each loan in the final approval stages on a weekly basis and track all loan applications from the time they are received.

Question: Given your desire to reduce REA program levels, what assurances can you give this committee that you aren't deliberately slowing down the review and approval of loan applications to achieve this Administration's philosophical objectives, contrary to the expressed will of Congress?

Answer: REA is continuing to review and approve loans in the normal manner. Currently, we expect to meet the minimum levels established for the electric program. If the telephone program receives additional completed applications, we may meet the minimum established for insured telephone and Rural Telephone Bank loans.

Question: What have you done during your tenure to ensure that the loan making process is as simple, brief and efficient as possible?

Answer: REA has always sought to make the loan application procedure as simple and straightforward as possible. In 1983, REA issued the first of a new series of publications called "Electric Operations Manuals". This publication, "Guide for the Preparation of Electric Distribution Loan Applications" is an example of simplifying the process. Also, REA has reissued its environmental regulations (7 CFR 1794) which reduced the burden and expedited loan submission and processing.

A preliminary draft of a new telephone regulation on Preloan Procedures and Requirements is presently under review. This proposed regulation simplifies a number of our preloan requirements. By eliminating unnecessary and/or duplicate support data, the Agency has been able to reduce and simplify the information required of borrowers, especially for subsequent loans. We are also drafting regulations on postloan policies, requirements, and procedures.

REA is continuing to study ways to reduce the loan application burden on borrowers while meeting its responsibility under the RE Act.

Question: When will you modernize and streamline these cumbersome procedures which are discouraging borrowers from applying for needed loans and costing rural ratepayers money?

Answer: We are continuing to work on procedures to be followed by the borrowers in preparing and submitting the required data to support their loan applications. We do not believe our requirements have kept eligible borrowers from applying for loans.

In the past three years, the number of electric loan applications has increased from 161 in FY 1984 to 227 in FY 1986. For the first five months of fiscal year 1987, REA has approved 80 distribution loans, compared to 35 for the same period last year. The number and amounts of telephone loan applications have decreased as many telephone borrowers have modernized their systems to provide all one-party service.

GENERAL FUNDS

Question: For two years now, Congress has prohibited REA from using a general funds policy to deny or reduce loans or loan advances.

What has been the effect of this prohibition?

Answer: Loans must now be made for the full amount of the project, regardless of the borrower's ability to fund some of the construction. In addition, several loans were made to reimburse borrowers who had previously been required to contribute their own funds for a project.

Question: Have loan applications and loan drawdowns increased?

Answer: While the increase in the total amount of loan applications and advances cannot be fully attributed to the elimination of the general funds policy, there is no doubt that it had an impact. The number of applications received and the amount of loan funds advanced have increased for both the telephone and electric programs.

Question: The budget request for fiscal year 1988 does not include the prohibition for using a general funds policy. Does this mean that you propose to reinstate a general funds policy?

Answer: The fact that the 1988 budget did not include a "prohibition for using a general funds policy" does not mean that REA intends to reinstate a general funds policy. It simply was not addressed.

Question: If so, what would that policy be?

Answer: Several ideas have been considered; however, in view of Congressional directives to not consider a borrower's internally generated funds, no specific policy has been formulated.

RURAL TELEPHONE BANK INTEREST RATE

Question: Mr. Hunter, REA acknowledged that the current procedure that you use raises a serious question as to whether the current system of applying the Rural Telephone Bank's interest rates accurately reflects its statutory obligation to lend at the cost of money rate. However, the remedial action that you propose would only correct the problem for future loans.

If you violated the statute for past loans, shouldn't something be done to correct all those loans that were made at the wrong interest rate?

Answer: We have not violated our statutory obligation to lend Bank loan funds at the Bank's "cost of money rate as determined by the Governor". The Governor sets the interest rate taking into consideration the cost and projected cost of money.

Question: When did this problem first come to your attention?

Answer: In July 1986, the Board of Directors of the Rural Telephone Bank asked whether the current system of applying the Bank's interest rate accurately reflects its statutory obligation to lend at the "cost of money rate". Currently, the interest rate is established at the time the loan is made and all subsequent advances are charged that rate. The Board requested the Rural Telephone Bank staff to draft procedure to establish the cost of money rate for each advance. A proposed rule was drafted and sent forward for review. During the review process, the portion of the rule allowing borrowers the option of retroactively changing the interest rate on unadvanced funds was removed. The rule was published on February 26, 1987, as a proposed rule.

Question: What type of a correction would that entail?

Answer: No correction is required.

Question: Aren't the customers of these telephone systems which did not get the cheaper rate, due some type of a return?

Answer: All Bank loans have been made at the cost of money to the Bank.

Question: Haven't many borrowers been talked into rescinding loans set at high interest rates, even though the cost to the Bank to fund these loans is actually much lower?

Answer: Any loan rescission has been accomplished within the terms of the loan contract. The interest rate is not a factor.

Question: Are you currently applying the average cost of money to the Rural Telephone Bank to its borrowers?

Answer: We are currently applying the average cost of money rate to all Rural Telephone Bank loans.

Question: Why has this statutory provision not been adhered to in the past?

Answer: We have always adhered to the statutory provision of applying the average cost of money rate of the Bank to Bank loans.

Question: For how long has this malpractice been going on?

Answer: We are unaware of any malpractice.

GOALS

Question: Mr. Hunter, you state that Congress has established many goals for REA and that the goal of providing Federal credit for quality electric and telephone service is almost accomplished. What are the other goals that Congress has established for REA?

Answer: The primary goal of ensuring that adequate funds were available to rural electric and telephone systems has allowed the borrowers to develop into strong financial organizations. We recognize the monetary strength of REA's borrowers, their acceptance in the private sector and the availability of private funds at very attractive interest rates. We believe this is the goal Congress wanted to achieve when, in 1973, it declared as its policy that "rural electric and telephone systems should be encouraged and assisted to develop their resources and ability to achieve the financial strength needed to enable them to satisfy their credit needs from their own financial organizations and other sources at reasonable rates and terms consistent with the loan applicant's ability to pay and achievement of the Act's objectives."

Question: Do you believe that one of the goals of REA is to ensure reasonable rates for rural subscribers?

Answer: Yes, I believe that one of REA's goals is to provide credit to electric and telephone borrowers that will ensure reasonable rural rates to subscribers.

LOAN LEVELS

Question: Mr. Hunter, in 1985, the Committee Report accompanying the fiscal year 1986 Appropriations Bill (99-137), indicated that this committee expected REA to distinguish between loans approved and loans advanced when determining whether minimum loan levels are met for each fiscal year. We felt it was misleading to include approved loans if REA eventually refuses to advance, or rescinds, these funds.

It has been almost two years now. Why haven't your reporting procedures been revised to incorporate the committee recommendations?

Answer: We appreciate the committee's concern. The appropriation that REA receives annually establishes limits for the dollar amount of loans that the REA Administrator may approve during a fiscal year. Once a loan has been approved, the actual advance of funds from that loan normally occurs over a one to three year period. Therefore, there is no relationship between the dollar amount of loan funds advanced in a fiscal year and the loan levels that are appropriated for that same fiscal year.

Question: I understand that the Rural Telephone Bank rescinded almost $50 million last year in previously approved loans, making your failure to meet the minimum loan levels set by Congress even more dramatic than you have reported to us.

When will you correct this deceptive practice?

Answer: There is no relationship between loan levels that are appropriated for a given fiscal year and advances or rescissions that may occur in the same fiscal year. The dollars represented by the advances or rescissions would have been appropriated in an earlier year in nearly every instance.

LOAN RESCISSIONS

Question: Please furnish to this committee a list of all loans, electric and telephone, which you have rescinded during your tenure as Administrator. Also, please show the effect these rescissions have had upon your compliance, or lack thereof, with the minimum loan levels for each program for each fiscal year during this same period, contrasting the totals for loans you claimed to have approved and the net amounts after taking into account these rescissions.

Answer: The rescissions have had no effect on the compliance with minimum loan levels. Loans are not usually rescinded in the year in which they are approved. The loan rescissions were done because the original loan funding was no longer needed for the stated loan purpose. This was also true for all those rescissions made by previous Administrators. These actions did not result in any required facilities not being constructed in a timely manner, nor were they used to circumvent the intent of Congress as to the level of loan making.

With one exception, every year since I have been Administrator, REA has approved insured electric loans at the levels authorized by Congress. The minimum levels for insured telephone and RTB loans were not met because the number of loan applications and the amounts have decreased substantially in the past five years. Most borrowers have upgraded their systems to all one-party service and are now borrowing funds to change over their switching equipment to digital. While this cost is substantial, it does not compare to the cost of outside plant construction when all one-party upgrading is undertaken. The decrease in telephone loan applications has occurred because upgrading to one-party service has virtually been completed.

A list of all REA electric and telephone loans rescinded from 1981 to 1987 will be provided for the record. A table of lending activity for the telephone and electric programs will also be provided. [The information follows:]

LENDING ACTIVITY OF REA-FISCAL YEARS 1981-1986
(Dollars in thousands)

	Telephone Insured		Telephone Guaranteed		RTB	
Fiscal Year	Minimum Level	Loans Approved	Minimum Level	Loans Approved	Minimum Level	Loans Approved
1986	$239,250	$183,340	$119,625	$0	$177,045	$127,897
1985	250,000	224,589	125,000	0	185,000	167,773
1984	250,000	228,559	125,000	105,099	185,000	143,028
1983	250,000	250,758	145,000	53,949	185,000	171,615
1982	250,000	249,345	*	76,979	160,000	184,775
1981	250,000	249,788	*	136,367	160,000	159,949

	Electric Insured		Electric Guaranteed	
Fiscal Year	Minimum Level	Loans Approved	Minimum Level	Loans Approved
1986	$622,050	$651,933	$813,450	$1,167,512
1985	850,000	562,029	1,200,000	74,607
1984	850,000	850,000	3,235,000	897,205
1983	850,000	850,000	4,600,000	3,388,292
1982	850,000	850,000	*	5,064,594
1981	850,000	850,000	*	4,994,960

*Committee recommendations not provided by program.

RURAL ELECTRIFICATION ADMINISTRATION
LISTING OF REA ELECTRIC LOAN RECISIONS FROM 1981-MAR. 1987

APRIL 10, 1987

FISCAL YEAR =1981

OBS	BORROWER NAME	CITY STATE ZIP	STATE NAME	BORR NUMBER	RECISION DATE	REA LOAN	GUARANTEED LOAN
1	PRENTISS COUNTY ELEC POW ASSN	BOONEVILLE MS 38829	MS	46	09/16/1981	200,000	0

FISCAL YEAR =1982

OBS	BORROWER NAME	CITY STATE ZIP	STATE NAME	BORR NUMBER	RECISION DATE	REA LOAN	GUARANTEED LOAN
2	SOUTH MISS ELEC POWER ASSN	HATTIESBURG MS 39404	MS	53	05/06/1982	0	13,546,000
3	OGLETHORPE POWER CORPORATION	TUCKER GA 30085	GA	109	06/28/1982	0	3,627,783
4	BASIN ELECTRIC POWER COOP	BISMARCK ND 58501	ND	45	08/19/1982	0	33,563,747
FISCALYR				FY 1982 Total		0	50,737,530

FISCAL YEAR =1983

OBS	BORROWER NAME	CITY STATE ZIP	STATE NAME	BORR NUMBER	RECISION DATE	REA LOAN	GUARANTEED LOAN
5	MINNKOTA POWER COOP INC	GRAND FORKS ND 58201	ND	20	11/01/1982	0	67,038,000
6	WABASH VALLEY POWER ASSN INC	INDIANAPOLIS IN 46224	IN	107	04/04/1983	0	40,000,000
7	SHO ME POWER CORP	MARSHFIELD MO 65706	MO	59	04/20/1983	0	388,414
8	SEMINOLE ELECTRIC COOP INC	TAMPA FL 33688	FL	41	05/04/1983	0	69,000
9	4 COUNTY ELEC POWER ASSOC	COLUMBUS MS 39701	MS	29	05/06/1983	2,825,000	0
10	NORTHERN MICH ELEC COOP INC	BOYNE CITY MI 49712	MI	47	05/10/1983	0	244
11	TOMBIGBEE ELEC POWER ASSN	TUPELO MS 38802	MS	49	06/17/1983	3,886,000	0
12	ASSOCIATED ELEC COOP INC	SPRINGFIELD MO 65801	MO	73	07/15/1983	0	584,160,000
13	WESTERN FARMERS ELEC COOP	ANADARKO OK 73005	OK	32	07/15/1983	0	466,861,000
FISCALYR				FY 1983 Total		6,711,000	1,158,516,658

FISCAL YEAR =1984

OBS	BORROWER NAME	CITY STATE ZIP	STATE NAME	BORR NUMBER	RECISION DATE	REA LOAN	GUARANTEED LOAN
14	PACIFIC NW GENERATING COMPANY	PORTLAND OR 97232	OR	42	10/31/1983	141,500	0
15	CITY OF LAFOLLETTE ELEC DEPT	LA FOLLETTE TN 37766	TN	45	01/12/1984	8,000	0

16	OGLETHORPE POWER CORPORATION	TUCKER GA 30085	GA	109	02/15/1984	0	224,231,939
17	SOYLAND POWER COOPERATIVE INC	DECATUR IL 62525	IL	53	02/28/1984	0	4,200,000
18	FLOWELL ELEC ASSN INC	FILLMORE UT 84631	UT	11	04/23/1984	146,500	0
19	CARROLL COUNTY R E M C	DELPHI IN 46923	IN	24	07/03/1984	297,000	0
20	EASTERN MAINE ELEC COOP INC	CALAIS ME 04619	ME	12	07/03/1984	350,000	0
21	VALLEY RUR ELEC COOP INC	HUNTINGDON PA 16652	PA	20	07/16/1984	1,214,000	0
22	VIRGIN ISLANDS WATER & POWER AUTH	ST THOMAS VI 00801	VO	2	07/16/1984	2,920,000	0
23	PARKE COUNTY R E M C	ROCKVILLE IN 47872	IN	42	07/18/1984	1,217,600	0
24	FRENCH BROAD ELEC MEMB CORP	MARSHALL NC 28753	NC	46	07/26/1984	735,000	0
25	HOOSIER ENERGY DIV IND STWIDE REC	BLOOMINGTON IN 47402	IN	106	08/08/1984	0	20,596,000
26	ARKANSAS ELECTRIC COOP CORP	LITTLE ROCK AR 72219	AR	34	09/25/1984	0	6,149,238
27	POLK COUNTY RUR PUB POW DIS	STROMSBURG NE 68666	NE	4	09/25/1984	268,520	0
	ARKANSAS ELECTRIC COOP CORP	**LITTLE ROCK AR 72219**	**AR**	**34**	**09/26/1984**	**0**	**9,376,000**
	ARKANSAS ELECTRIC COOP CORP	**LITTLE ROCK AR 72219**	**AR**	**34**	**09/27/1984**	**0**	**20,501,815**
	MARIAS RIVER ELEC COOP INC	**SHELBY MT 59474**	**MT**	**31**	**09/27/1984**	**72,483**	**0**
	MARIAS RIVER ELEC COOP INC	**SHELBY MT 59474**	**MT**	**31**	**09/28/1984**	**480,000**	**0**
					FY 1984 Total	**7,050,003**	**285,054,992**

-- FISCAL YEAR =1985 --

BORROWER NAME	CITY STATE ZIP	STATE NAME	BORR NUMBER	RECISION DATE	REA LOAN	GUARANTEED LOAN
THE BROWN ATCHISON ELEC COOP ASSN	HORTON KS 66439	KS	13	10/06/1984	138,500	0
THE CPS ELEC COOP INC	MEADE KS 67864	KS	46	01/10/1985	134,000	0
WAYNE COUNTY PUB POW DIS	WAYNE NE 68787	NE	65	01/23/1985	107,610	0
NORTH CENTRAL P P D	CREIGHTON NE 68729	NE	05	03/01/1985	410,055	0
ARKANSAS ELECTRIC COOP CORP	LITTLE ROCK AR 72219	AR	34	03/13/1985	1,463,124	0
NYMAN ELEC COOP INC	STANTON IA 51573	IA	75	03/29/1985	151,500	0
THE DONIPHAN ELEC COOP ASSN INC	TROY KS 66087	KS	22	03/29/1985	65,000	0
VICTORY ELEC COOP ASSN INC	DODGE CITY KS 67801	KS	48	03/29/1985	674,000	0
PLAINS ELEC G AND T COOP INC	ALBUQUERQUE NM 87197	NM	18	04/03/1985	0	63,100,000
SOYLAND POWER COOPERATIVE INC	DECATUR IL 62525	IL	53	04/08/1985	0	824,000,000
CANEY FORK ELEC COOP INC	MCMINNVILLE TN 37110	TN	46	04/09/1985	1,120,000	0
NEW HAMPSHIRE E COOP INC	PLYMOUTH NH 03264	NH	4	04/17/1985	0	40,068,000
NORTH CAROLINA ELEC MEMB CORP	RALEIGH NC 27611	NC	67	05/15/1985	0	12,077,400
UNION RUR ELEC COOP INC	MARYSVILLE OH 43040	OH	50	05/21/1985	342,444	0
BLUE RIDGE ELEC COOP INC	PICKENS SC 29671	SC	38	05/21/1985	560,520	0
SAN MIGUEL ELECTRIC COOP INC	JOURDANTON TX 78026	TX	155	05/31/1985	0	59,102,000
CENTRAL MISSOURI ELEC COOP INC	SEDALIA MO 65301	MO	40	07/08/1985	1,030,000	0
M & A ELEC POWER COOP	POPLAR BLUFF MO 63901	MO	68	07/08/1985	0	1,460,000
UNITED RURAL ELEC COOP INC	KENTON OH 43326	OH	85	07/12/1985	653,000	0
COLORADO UTE ELEC ASSN INC	MONTROSE CO 81402	CO	46	07/18/1985	0	117,857,400
WRIGHT COUNTY R E COOP	CLARION IA 50525	IA	36	07/18/1985	922,000	0
PACIFIC NW GENERATING COMPANY	PORTLAND OR 97232	OR	42	07/18/1985	0	15,699,000
ASSOCIATED ELEC COOP INC	SPRINGFIELD MO 65801	MO	73	07/23/1985	0	80,480,000

	TRUCKEE DONNER PUB UTIL DIST	TRUCKEE CA 95734	CA	44	08/26/1985	65,426	0
	PACIFIC NW GENERATING COMPANY	PORTLAND OR 97232	OP	42	08/27/1985	0	924,000
	UNITED POWER ASSOCIATION	ELK RIVER MN 55330	MN	107	09/05/1985	0	11,552,000
	WESTERN FARMERS ELEC COOP	ANADARKO OK 73005	OK	32	09/13/1985	0	6,083,000
	FRANKLIN COUNTY RUR PUB POW DIS	FRANKLIN NE 68939	NE	102	09/17/1985	37,000	0
	ASSOCIATED ELEC COOP INC	SPRINGFIELD MO 65801	MO	73	09/20/1985	0	103,790,506
	SALUDA RIVER ELECTRIC COOP INC	LAURENS SC 29360	SC	51	09/30/1985	0	2,985,000
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				FY 1985 Total		7,869,987	1,347,170,386

FISCAL YEAR =1986

OBS	BORROWER NAME	CITY STATE ZIP	STATE NAME	BORR NUMBER	RECISION DATE	REA LOAN	GUARANTEED LOAN
62	THE JEWEL MITCHELL COOP ELEC CO INC	MANKATO KS 66956	KS	7	11/22/1985	776,074	0
63	VICTORY ELEC COOP ASSN INC	DODGE CITY KS 67801	KS	48	11/22/1985	1,463,000	0
64	EAST KENTUCKY POWER COOP INC	WINCHESTER KY 40391	KY	59	11/22/1985	0	121,477,167
65	WOLVERINE POWER SUPPLY COOP INC	BOYNE CITY MI 49712	MI	46	11/22/1985	0	740,000
66	WOLVERINE POWER SUPPLY COOP INC	BOYNE CITY MI 49712	MI	46	11/23/1985	2,398,000	0
67	ARKANSAS ELECTRIC COOP CORP	LITTLE ROCK AR 72219	AR	34	12/03/1985	0	18,000,000
68	BOONE COUNTY R E M C	LEBANON IN 46052	IN	6	12/03/1985	525,000	0
69	ARKANSAS ELECTRIC COOP CORP	LITTLE ROCK AR 72219	AR	34	12/04/1985	0	30,421,000
70	SO NEBR RURAL PUB PWR DIST	GRAND ISLAND NE 68802	NE	76	12/31/1985	2,334,000	0
71	EAST RIVER ELEC POW COOP INC	MADISON SD 57042	SD	43	01/08/1986	0	200,000
72	ONEIDA MADISON ELEC COOP INC	BOUCKVILLE NY 13310	NY	24	01/21/1986	275,000	0
73	OGLETHORPE POWER CORPORATION	TUCKER GA 30085	GA	109	02/12/1986	0	309,610,000
74	KAMO ELECTRIC COOP INC	VINITA OK 74301	AR	32	02/18/1986	0	12,130,000
75	DESERET G&T COOPERATIVE INC	SANDY UT 84070	UT	21	02/21/1986	0	14,476,000
76	SEMINOLE ELECTRIC COOP INC	TAMPA FL 33688	FL	41	02/27/1986	0	203,245,000
77	ASSOCIATED ELEC COOP INC	SPRINGFIELD MO 65801	MO	73	03/18/1986	1,509,130	0
78	TRI STATE G & T ASSN INC	DENVER CO 80233	CO	47	03/28/1986	0	68,838,000
79	BASIN ELECTRIC POWER COOP	BISMARCK ND 58501	ND	45	04/04/1986	0	244,850,000
80	CARBON POWER AND LIGHT INC	SARATOGA WY 82331	WY	21	04/04/1986	2,183,675	0
81	BASIN ELECTRIC POWER COOP	BISMARCK ND 58501	ND	45	04/05/1986	0	241,150,000
82	TRI STATE G & T ASSN INC	DENVER CO 80233	CO	47	04/09/1986	0	966,000
83	HOOSIER ENERGY DIV IND STWIDE REC	BLOOMINGTON IN 47402	IN	106	04/21/1986	0	125,000,000
84	CAJUN ELEC POWER COOP INC	BATON ROUGE LA 70895	LA	30	05/27/1986	0	2,760,000
85	CAJUN ELEC POWER COOP INC	BATON ROUGE LA 70895	LA	30	05/28/1986	0	1,087,000,000
86	OGLETHORPE POWER CORPORATION	TUCKER GA 30085	GA	109	06/19/1986	0	1,613,000
87	DESERET G&T COOPERATIVE INC	SANDY UT 84070	UT	21	06/30/1986	0	16,818,277
88	CENTRAL POWER ELEC COOP INC	MINOT ND 58702	ND	42	07/02/1986	54,352	0
89	EAST KENTUCKY POWER COOP INC	WINCHESTER KY 40391	KY	59	07/07/1986	0	49,107,571
90	ALABAMA ELEC COOP INC	ANDALUSIA AL 36420	AL	42	07/09/1986	0	240,000
91	MENARD ELEC COOP	PETERSBURG IL 62675	IL	21	07/31/1986	67,000	0
92	OGLETHORPE POWER CORPORATION	TUCKER GA 30085	GA	109	08/21/1986	0	7,731,000
93	OGLETHORPE POWER CORPORATION	TUCKER GA 30085	GA	109	08/22/1986	0	3,340,392
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				FY 1986 Total		11,585,231	2,559,713,407

FISCAL YEAR =1987

OBS	BORROWER NAME	CITY STATE ZIP	STATE NAME	BORR NUMBER	RECISION DATE	REA LOAN	GUARANTEED LOAN
94	MORGAN COUNTY R E M C	MARTINSVILLE IN 46151	IN	60	12/01/1966	1,262,000	0
95	CENTRAL ELEC POW COOP INC	COLUMBIA SC 29202	SC	50	12/01/1986	627,800	0
96	HAYWOOD ELECTRIC MEMB CORP	WAYNESVILLE NC 28786	NC	10	12/17/1986	196,350	0
97	DEAF SMITH ELECTRIC COOP INC	HEREFORD TX 79045	TX	47	12/31/1986	1,919,000	0
98	GUADALUPE VALLEY E C INC	GONZALES TX 78629	TX	94	12/31/1986	913,000	0
99	EAST KENTUCKY POWER COOP INC	WINCHESTER KY 40391	KY	59	01/30/1987	0	1,671,000
100	NORTHEAST TEXAS ELECTRIC COOP.INC	LONGVIEW TX 75601	TX	158	02/09/1987	0	11,279,000
101	NORTHWEST KANSAS ELEC COOP ASSN INC	BIRD CITY KS 67731	KS	49	03/04/1987	411,175	0
102	ARKANSAS ELECTRIC COOP CORP	LITTLE ROCK AR 72219	AR	34	03/17/1987	0	2,364,185
103	ALLEGHENY ELECTRIC COOP INC	HARRISBURG PA 17108	PA	27	03/23/1987	145,000	0
104	ALLEGHENY ELECTRIC COOP INC	HARRISBURG PA 17103	PA	27	03/24/1987	142,000	0
	SHERIDAN JOHNSON RUR ELEC	**SHERIDAN WY 82801**	**WY**	**24**	**03/24/1987**	**1,118,642**	**0**
	TRI COUNTY ELEC ASSN INC	**SUNDANCE WY 82729**	**WY**	**25**	**03/31/1987**	**0**	**6,891,000**
						6,734,967	22,405,185
	FY 1981 - March 1987 Total					**40,958,188**	**5,423,606,158**

RURAL ELECTRIFICATON ADMINISTRATION
LISTING OF REA TELEPHONE LOAN RECISIONS
FROM 1981 TO FEB. 1987

APRIL 10, 1987

-- FISCAL YEAR =1981 --

OBS	STATE NAME	BORR NUMBER	BORROWER NAME	CITY STATF ZIP	RECISION DATE	RURAL TELEPHONE BANK LOAN	REA INSURED LOAN	GUARANTEED LOAN
1	VA	524	MOUNTAIN GROVE WILLIAMSVILLE TEL CO	WILLIAMSVILLE VA 24487	01/19/81	44,782	0	0
2	IL	549	ODIN TELE EXCHANGE INC	ODIN IL 62870	02/02/81	59,953	0	0
3	IA	623	RADCLIFFE TELEPHONE COMPANY	RADCLIFFE IA 50230	02/02/81	0	159,102	0
4	MN	547	WOODSTOCK TELE CO	RUTHTON MN 56170	03/06/81	0	128,001	0
5	CO	501	WIGGINS TEL ASSN	WIGGINS CO 80654	03/17/81	0	786,000	0
6	NE	536	PIERCE TELE COMPANY INC	PIERCE NE 68767	03/17/81	0	5,975	0
7	IA	619	STRATFORD MUTUAL TEL CO	STRATFORD IA 50249	04/07/81	0	52,000	0
8	AZ	505	CONTINENTAL TEL CO OFTHE WEST	PHOENIX AZ 85001	04/09/81	837,217	0	0
9	KS	549	THE RAINBOW TELE COOP ASSOC	EVEREST KS 66424	04/21/81	0	159,493	0
10	WA	542	KALAMA TELEPHONE COMPANY	KALAMA WA 98625	05/28/81	2,427,600	0	0
11	IA	584	COON VALLEY COOP TEL ASSN INC	MENLO IA 50164	06/24/81	0	38,003	0
12	NJ	503	UNITED-SUSSEX TELEPHONE CO INC	CARLISLE PA 17013	06/25/81	1,260,000	0	0
13	VA	528	CENTRAL TELEPHONE CO. OF VA.	CHARLOTTESVILLE , VA.	06/29/81	576,450	0	0
14	WI	538	SHELL LAKE TELEPHONE CO INC	SHELL LAKE WI 54871	07/08/81	0	82,379	0
15	IA	585	SCHALLER TELEPHONE COMPANY	SCHALLER IA 51053	07/21/81	0	83,940	0
16	KS	589	THE PEOPLES MUTUAL TEL CO	LA CYGNE KS 66040	08/10/81	0	194,896	0
17	AR	541	REDFIELD TELEPHONE CO INC	REDFIELD AR 73132	08/14/81	0	1,690,000	0
18	IA	586	CASEY MUTUAL TEL CO	CASEY IA 50048	08/25/81	0	167,400	0
19	IA	622	MONTEZUMA MUTUAL TELEPHONE CO	MONTEZUMA IA 50171	08/25/81	0	235,000	0
20	KS	550	BURDETT TELEPHONE CO INC	RUSH CENTER KS 67575	08/25/81	61,405	0	0
21	IL	567	CASS COUNTY TEL CO	VIRGINIA IL 62691	08/31/81	898	67,000	0
22	IA	607	SCRANTON TELEPHONE COMPANY	SCRANTON IA 51462	09/04/81	0	52,181	0
23	MN	603	DANUBE TELEPHONE COMPANY	DANUBE MN 56230	09/09/81	0	49,461	0
24	MN	541	SCOTT RICE TELEPHONE CO INC	PRIOR LAKE MN 55372	09/10/81	1,517,352	0	0
25	OK	549	CHEROKEE TELEPHONE COMPANY	CALERA OK 74730	09/16/81	95,420	0	0
26	MN	558	ALBANY MUTUAL TELEPHONE ASSN	ALBANY MN 56307	09/28/81	280,930	0	0
27	MN	608	NORTHLAND TEL CO	HILL CITY MN 55748	09/28/81	111,296	0	0
28	MN	618	ARROWHEAD COMMUNICATIONS CORP	HECTOR MN 55342	09/28/81	0	40,000	0
29	ND	515	INTER COMMUNITY TELE CO	NOME ND 58062	09/28/81	0	94,033	0
30	OR	533	GERVAIS TELEPHONE COMPANY	GERVAIS OR 97026	09/28/81	0	60,000	0
31	IL	526	ALHAMBRA GRANTFORK TEL CO	ALHAMBRA IL 62001	09/30/81	170,836	0	0
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FY				FY 1981 Total		7,444,139	4,144,864	0

FISCAL YEAR -1982

OBS	STATE NAME	BORR NUMBER	BORROWER NAME	CITY STATE ZIP	RECISION DATE	RURAL TELEPHONE BANK LOAN	REA INSURED LOAN	GUARANTEED LOAN
32	PA	550	LEESPORT TELEPHONE COMPANY	DALLAS PA 18612	10/15/81	0	0	950,000
33	CO	528	STRASBURG TELEPHONE COMPANY	STRASBURG CO 80136	10/30/81	51,881	0	0
34	CO	528	STRASBURG TELEPHONE COMPANY	STRASBURG CO 80136	10/30/81	157,500	0	0
35	MN	613	LAKEDALE TELEPHONE CO	ANNANDALE MN 55302	10/30/81	791,310	0	0
36	CO	509	HAXTUN TELEPHONE COMPANY	ST LOUIS MO 63141	11/02/81	0	194,127	0
37	MN	614	MADELIA TEL CO	MADELIA MN 56062	11/09/81	188,735	20,000	0
38	CO	518	PLAINS COOP TELE ASSN INC	JOES CO 80822	11/16/81	0	368,077	0
39	NE	538	GREAT PLAINS COMMUNICATIONS	BLAIR NE 68008	11/16/81	0	84,379	0
40	MN	616	BLACKDUCK TELEPHONE COMPANY	BLACKDUCK MN 56630	11/27/81	126,711	0	0
	WI	519	CITIZENS TELE COOP INC	NEW AUBURN WI 54757	11/27/81	176,400	0	0
	WI	519	CITIZENS TELE COOP INC	NEW AUBURN WI 54757	11/27/81	61,712	0	0
	KS	520	PLEASANTON TELEPHONE COMPANY	GIRARD, KS 66743	12/07/81	272,288	0	0
	VA	523	PEMBROKE TELEPHONE COOP	PEMBROKE VA 24136	12/09/81	288,750	0	0
	IA	536	FARMERS TELEPHONE CO	ESSEX IA 51638	12/17/81	0	54,705	0
	TX	616	BYERS PETROLIA TELE CO INC	BYERS TX 76357	01/22/82	0	162,114	0
	IA	587	IAMO TELEPHONE COMPANY	COIN IA 51636	02/05/82	0	195,769	0
	IA	613	PANORA COOP TELE ASSOC INC	PANORA IA 50216	02/05/82	0	97,001	0
	IA	634	HOSPERS TEL EXCHANGE INC	HOSPERS IA 51238	02/05/82	0	54,866	0
	WI	571	BADGER STATE TELEPHONE CO INC	MADISON WI 53705	02/08/82	151,634	0	0
	WI	575	VALDERS TELEPHONE COMPANY	MADISON WI 53705	02/08/82	99,071	0	0
	WI	579	MOSEL AND CENTERVILLE TEL CO	MADISON WI 53705	02/08/82	30,091	0	0
	WI	583	BLACK EARTH TELE COMPANY	MADISON WI 53705	02/08/82	72,660	0	0
	WI	586	WAUNAKEE TELEPHONE COMPANY	MADISON WI 53705	02/09/82	261,979	0	0
	WI	549	BURLINGTON BRIGHTON WHEATLAND TEL	MADISON WI 53705	02/19/82	305,268	0	0
	WI	566	DODGE COUNTY TELEPHONE CO	MADISON WI 53705	02/19/82	132,373	0	0
	WI	569	PEOPLES TELE COMPANY	MADISON WI 53705	02/19/82	431,905	0	0
	WI	588	THE MT VERNON TELEPHONE CO	MADISON WI 53705	02/19/82	545,690	0	0
	WI	610	MIDWAY TELEPHONE COMPANY	MADISON WI 53705	02/19/82	734,594	0	0
	WI	612	FENNIMORE TELEPHONE COMPANY	MADISON WI 53705	02/19/82	0	224,383	0
	KS	576	BLUE VALLEY TELE COMPANY	HOME KS 66438	02/23/82	0	506,000	0
	MO	568	OREGON FARMERS MUT TELE CO	OREGON MO 64473	02/23/82	0	211,510	0
	IA	503	MUTUAL TELEPHONE CO	SIOUX CENTER IA 51250	03/05/82	210,000	0	0
	KS	587	JETMORE TELEPHONE CO INC	DODGE CITY KS 67801	03/23/82	0	12,155	0
	WI	562	RIB LAKE TELEPHONE CO	RIB LAKE WI 54470	03/23/82	0	36,000	0
	CO	527	THE BIJOU TELEPHONE COOP ASSN	BYERS CO 80103	03/30/82	0	152,403	0
	AL	558	ONEONTA TELEPHONE CO. INC.	ONEONTA , ALABAMA	04/26/82	500,850	5,367,000	0
	FL	504	ORANGE CITY TEL CO INC	ALTAMONTE SPRINGS FL 32701	04/26/82	0	0	122,000
	FL	506	QUINCY TELEPHONE COMPANY	MADISON WI 53705	04/26/82	0	0	842,000
	AL	542	OAKMAN TELEPHONE CO INC	OAKMAN AL 35579	05/04/82	0	559,154	0
	IA	535	THE FARMERS MUTUAL TELE CO	STANTON IA 51573	05/14/82	141,750	4,000	0
	MN	575	SACRED HEART TELE COMPANY	CLARA CITY MN 56222	05/14/82	0	4,321	0
	MN	516	ROTHSAY TELE COMP INC	ROTHSAY MN 56579	05/21/82	0	47,000	0
	WI	580	BALDWIN TELE EXCHANGE	BALDWIN WI 54002	06/14/82	28,162	0	0
	MN	613	LAKEDALE TELEPHONE CO	ANNANDALE MN 55302	06/29/82	448,783	0	0

SC	522	SANDHILL TELE COOP INC	JEFFERSON SC 29718	06/30/82	2,205,000	0	0
SC	522	SANDHILL TELE COOP INC	JEFFERSON SC 29718	06/30/82	1,669,000	0	0
KS	581	MOUNDRIDGE TELEPHONE COMPANY	MOUNDRIDGE KS 67107	07/21/82	55,650	0	0
KS	580	WAMEGO TELEPHONE CO INC	WAMEGO KS 66547	08/12/82	0	1,363,150	0
TX	643	THE LA WARD TELE EXCH INC	LA WARD TX 77970	08/12/82	0	165,000	0
WI	549	BURLINGTON BRIGHTON WHEATLAND TEL	MADISON WI 53705	08/19/82	67,200	0	0
WI	571	BADGER STATE TELEPHONE CO INC	MADISON WI 53705	08/19/82	177,890	0	0
WI	610	MIDWAY TELEPHONE COMPANY	MADISON WI 53705	08/26/82	114,097	0	0
KS	571	CUNNINGHAM TELE CO INC	GLEN ELDER KS 67446	09/10/82	0	164,000	0
OK	540	THE HYDRO TELE COMPANY	HINTON OK 73047	09/10/82	0	59,594	0
MN	515	PINE ISLAND TELE CO	HECTOR MN 55342	09/30/82	0	93,289	0
			FY 1982 Total		10,698,943	10,200,596	1,914,000

FISCAL YEAR =1983

OBS	STATE NAME	BORR NUMBER	BORROWER NAME	CITY STATE ZIP	RECISION DATE	RURAL TELEPHONE BANK LOAN	REA INSURED LOAN	GUARANTEED LOAN
87	KS	583	THE TRI-COUNTY TEL ASSN INC	COUNCIL GROVE KS 66846	10/19/82	0	904,000	0
88	AL	549	CASTLEBERRY TELEPHONE CO INC	CASTLEBERRY AL 36432	11/01/82	0	214,770	0
89	ME	524	SOMERSET TELEPHONE COMPANY	NORTHFIELD VT 05663	11/22/82	0	0	3,425,000
90	NJ	502	HILLSBOROUGH AND MONTGOMERY TEL CO	CARLISLE PA 17013	02/03/83	0	0	3,416,000
91	ND	527	POLAR COMMUNICATIONS MUTUAL AID	PARK RIVER ND 58270	02/03/83	0	367,000	0
92	KS	574	TWIN VALLEY TELEPHONE INC	MILTONVALE KS 67466	02/18/83	0	869,000	0
93	IL	570	LEAF RIVER VALLEY TEL CO	LEAF RIVER IL 61047	02/25/83	0	3,853	0
94	IA	625	CASCADE TELEPHONE COMPANY	CASCADE IA 52033	02/25/83	0	168,000	0
95	IA	625	CASCADE TELEPHONE COMPANY	CASCADE IA 52033	02/25/83	0	210,000	0
96	WI	613	FORESTVILLE TELEPHONE COMPANY	MILWAUKEE WI 53203	02/25/83	0	64,141	0
97	MT	515	NORTHERN TELE COOP INC	SUNBURST MT 59482	03/31/83	0	1,222,399	0
98	WI	507	MARQUETTE ADAMS TEL COOP INC	OXFORD WI 53952	05/03/83	3,935	0	0
99	WI	526	CREAM VALLEY TELEPHONE CO	MILWAUKEE WI 53203	05/18/83	0	470,000	0
100	IA	571	NORTHERN IOWA TELEPHONE CO	SIOUX CENTER IA 51250	05/27/83	219,802	0	0
101	IA	615	NORTHWEST IOWA TELE CO INC	SGT BLUFF IA 51054	05/27/83	53,204	0	0
102	IA	507	THE CITIZENS MUTUAL TELE CO	BLOOMFIELD IA 52537	06/24/83	0	513,108	0
103	WI	603	WAYSIDE TELEPHONE COMPANY	GREENLEAF WI 54126	06/29/83	11,440	0	0
104	WI	632	NIAGARA TELEPHONE COMPANY	WITTENBERG WI 54499	06/29/83	277,200	0	0
105	MN	615	K M P TELEPHONE CO	KERKHOVEN MN 56252	07/21/83	0	245,614	0
106	IA	638	SWISHER TELEPHONE COMPANY	SWISHER IA 52338	07/22/83	0	258,185	0
107	NY	543	DELHI TELEPHONE COMPANY	DELHI NY 13753	07/28/83	354,900	0	0
108	NY	501	PATTERSONVILLE TELEPHONE CO	ROTTERDAM JCT NY 12150	08/12/83	320,775	0	0
109	IA	649	MID IOWA TELEPHONE COOP ASSOCIATION	GILMAN IA 50106	08/16/83	1,328,250	0	0
110	MI	521	SOUTHERN TEL COMPANY	JACKSON MI 49204	08/31/83	0	0	2,647,000
111	CA	515	SIERRA TELE COMPANY INC	OAKHURST CA 93644	09/14/83	0	0	5,000
112	CA	526	PONDEROSA TELEPHONE COMPANY	O NEALS CA 93645	09/14/83	0	0	39,000
113	MI	548	BLANCHARD TELEPHONE ASSN INC	BLANCHARD MI 49310	09/21/83	229,950	0	0

114	PA	518	BROOKVILLE TELEPHONE COMPANY	EXPORT PA 15632	09/21/83	0	0	105,000
115	PA	519	LEWISBERRY TELEPHONE CO	DALLAS PA 18612	09/27/83	2,809,800	0	0
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FY				FY 1983 Total		5,609,256	5,510,070	9,637,000

---------- FISCAL YEAR =1984 ----------

OBS	STATE NAME	BORR NJMBER	BORROWER NAME	CITY STATE ZIP	RECISION DATE	RURAL TELEPHONE BANK LOAN	REA INSURED LOAN	GUARANTEED LOAN
116	NY	525	ONEIDA COUNTY RURAL TEL CO	HOLLAND PATENT NY 13354	10/03/83	0	112,500	0
117	NY	534	TACONIC TELEPHONE CORP	CHATHAM NY 12037	10/11/83	0	0	1,575,000
118	AL	532	ELMORE COOSA TELEPHONE CO INC	MATTHEWS NC 28105	10/26/83	0	0	33,000
119	MN	513	FELTON TELE EXCHANGE INC	FELTON MN 56536	10/26/83	0	111,268	0
120	NY	525	ONEIDA COUNTY RURAL TEL CO	HOLLAND PATENT NY 13354	11/03/83	0	0	0
121	OH	526	THE BUCKLAND MUTUAL TEL CO	BUCKLAND OH 45819	11/09/83	0	63,000	0
122	NC	508	MEBANE HOME TELEPHONE CO INC	MEBANE NC 27302	12/01/83	512,078	840,000	0
123	IN	524	CLAY COUNTY RUR TEL COOP INC	CLOVERDALE IN 46120	12/23/83	0	1,204,939	0
124	IA	520	FARMERS MUTUAL COOP TEL CO	HARLAN IA 51537	12/23/83	49,595	0	0
125	OR	521	COLTON TELEPHONE COMPANY	COLTON OR 97017	01/12/84	114,450	0	0
126	MN	620	EMILY COOPERATIVE TELEPHONE CO	EMILY MN 56447	01/17/84	0	202,006	0
127	NE	527	DILLER TELEPHONE CO	DILLER NE 68342	01/17/84	0	410,310	0
128	WI	501	CLEAR LAKE TEL CO INC	CLEAR LAKE WI 54005	02/09/84	0	92,913	0
129	PA	553	NORTH PITTSBURGH TELE CO	GIBSONIA PA 15044	02/24/84	2,991,537	0	0
130	IA	637	WALLINGFORD TELEPHONE COOP	WALLINGFORD IOWA 51365	03/06/84	0	31,513	0
131	NE	525	THREE RIVER TELCO	LYNCH NE 68746	03/06/84	0	259,000	0
132	NJ	503	UNITED-SUSSEX TELEPHONE CO INC	CARLISLE PA 17013	03/28/84	1,680,000	0	0
133	PA	552	OSWAYO RIVER TELEPHONE CO	SHINGLEHOUSE PA 16748	03/28/84	0	243,000	0
134	MI	539	CONCORD TELEPHONE CO INC	JACKSON MI 49204	03/29/84	0	531,000	0
135	PA	525	MARIANNA & SCENERY HILL TEL CO	MARIANNA PA 15345	04/10/84	0	595,430	0
136	MI	545	CLAYTON TELEPHONE COMPANY	CLAYTON MI 49235	04/13/84	0	91,000	0
137	SD	534	BISON STATE TELEPHONE CO INC	WENTZVILLE MO 63385	05/31/84	448,749	0	0
138	NE	551	HERSHEY COOP TELE COMPANY	HERSHEY NE 69143	06/21/84	52,639	0	0
139	NE	551	HERSHEY COOP TELE COMPANY	HERSHEY NE 69143	06/21/84	291,900	367,000	0
140	TN	525	CONCORD TEL EXCHANGE INC	CONCORD TN 37922	07/05/84	1,425,900	0	0
141	AZ	505	CONTINENTAL TEL CO OFTHE WEST	PHOENIX AZ 85001	08/01/84	0	0	680,000
142	AZ	505	CONTINENTAL TEL CO OFTHE WEST	PHOENIX AZ 85001	08/01/84	1,380,750	0	0
143	OR	542	MOLALLA TELEPHONE COMPANY	MOLALLA OR 97038	08/01/84	628,084	0	0
144	SC	526	HOME TELEPHONE COMPANY INC	MONCKS CORNER SC 29461	08/01/84	0	0	0
145	SC	526	HOME TELEPHONE COMPANY INC	MONCKS CORNER SC 29461	08/02/84	0	1,763,000	0
146	ID	503	CUSTER TELE COOP INC	CHALLIS ID 83226	08/09/84	936,600	110,948	0
147	IA	616	BREDA TELEPHONE CORPORATION	BREDA IA 51436	08/14/84	0	102,912	0
148	MN	606	LONSDALE TELEPHONE CO INC	LONSDALE MN 55046	08/16/84	0	119,612	0
149	MN	606	LONSDALE TELEPHONE CO INC	LONSDALE MN 55046	08/16/84	0	344,000	0
150	AZ	505	CONTINENTAL TEL CO OFTHE WEST	PHOENIX AZ 85001	09/18/84	0	0	36,020,000
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FY				FY 1984 Total		10,512,282	7,595,351	38,308,000

FISCAL YEAR =1985

OBS	STATE NAME	BORR NUMBER	BORROWER NAME	CITY STATE ZIP	RECISION DATE	RURAL TELEPHONE BANK LOAN	REA INSURED LOAN	GUARANTEED LOAN
151	NE	532	CLARKS TELEPHONE COMPANY	CLARKS NE 68628	10/18/84	0	177,000	0
152	NY	546	OGDEN TELEPHONE COMPANY	SPENCERPORT NY 14559	10/18/84	0	0	3,850,000
153	ID	505	PROJECT MUTUAL TEL COOP ASSN INC	RUPERT ID 83350	11/09/84	233,100	0	0
154	IA	555	BROOKLYN MUTUAL TELE CO	BROOKLYN IA 52211	11/09/84	0	325,920	0
155	IA	519	FARMERS COOP TELEPHONE CO	DYSART IA 52224	11/16/84	0	179,200	0
156	PA	551	COMMONWEALTH TELEPHONE CO	DALLAS PA 18612	11/16/84	0	0	35,721,000
157	MN	599	MABEL COOP TEL CO	MABEL MN 55954	12/21/84	366,150	0	0
158	NY	544	CLYMER TELEPHONE COMPANY INC	NORTH SYRACUSE NY 13212	12/28/84	0	135,250	0
159	WA	529	YELM TELE COMPANY	YELM WA 98597	12/28/84	132,040	0	0
160	VA	507	MERCHANTS AND FARMERS TEL CO	CHARLOTTESVILLE VA 22906	12/31/84	0	606,000	0
161	KY	536	THACKER GRIGSBY TELE CO INC	HINDMAN KY 41822	01/07/85	389,550	429,000	0
162	TX	528	WES TEX TELEPHONE COOP INC	STANTON TX 79782	01/07/85	0	180,000	0
163	TX	506	FIVE AREA TELE COOP INC	MULESHOE TX 79347	01/14/85	0	3,109,000	0
164	TX	559	SANTA ROSA TEL COOP INC	VERNON TX 76384	01/14/85	0	902,000	0
165	CO	525	COLUMBINE TELEPHONE CO	FREEDOM WY 83120	01/15/85	0	247,000	0
166	NE	552	NORTHERN TELEPHONE CO	BLAIR NE 68008	01/15/85	34,506	0	0
167	NE	562	UNION TELEPHONE CO	BLAIR NE 68008	01/15/85	[illegible]	232,000	0
168	TX	634	COMANCHE COUNTY TELE CO INC	DE LEON TX 76444	01/15/85	0	444,766	0
169	WI	620	MONROE COUNTY TELEPHONE CO	MILWAUKEE WI 53203	01/15/85	0	986,000	0
170	WI	631	SOUTHEAST TEL CO OF WISCONSIN	WATERFORD WI 53185	01/15/85	147,381	0	0
171	MO	535	CHARITON VALLEY TEL CORP	BUCKLIN MO 64631	01/22/85	218,505	0	0
172	MO	535	CHARITON VALLEY TEL CORP	BUCKLIN MO 64631	01/22/85	2,420,250	0	0
173	TX	522	MID PLAINS RUR TEL COOP INC	TULIA TX 79088	01/22/85	0	1,484,000	0
174	WI	568	LAVALLE TELE COOP	LAVALLE WI 53941	01/22/85	118,919	0	0
175	IN	529	GEETINGSVILLE TELE CO INC	FRANKFORT IN 46041	01/30/85	0	35,074	0
176	LA	501	EAST ASCENSION TELE CO INC	GONZALES LA 70737	02/01/85	0	0	274,000
177	OR	544	MOUNT ANGEL TELEPHONE CO	MOUNT ANGEL OR 97362	02/01/85	663,915	0	0
178	KS	569	WILSON TELEPHONE CO INC	WILSON KS 67490	02/11/85	0	394,000	0
179	WA	503	LEWIS RIVER TELEPHONE CO INC	LACENTER WA 98629	02/12/85	361,725	0	0
180	MN	601	LOWRY TELEPHONE CO INC	LOWRY MN 56349	02/20/85	0	250,976	0
181	WI	602	ST CROIX TELEPHONE COMPANY	NEW RICHMOND WI 54017	02/20/85	976,132	0	0
182	WI	637	BRUCE TELEPHONE COMPANY INC	BRUCE WI 54819	02/20/85	0	770,000	0
183	OK	510	CROSS TELEPHONE COMPANY	WARNER OK 74469	02/25/85	0	365,264	0
184	SC	502	RIDGE TELEPHONE CO INC	RIDGE SPRING SC 29129	02/25/85	0	37,000	0
185	IA	506	WESTERN IOWA TELEPHONE ASSN	LAWTON IA 51030	03/01/85	272,317	0	0
186	OK	518	GRAND TELEPHONE CO INC	JAY OK 74346	03/02/85	3,578,400	0	0
187	OK	518	GRAND TELEPHONE CO INC	JAY OK 74346	03/03/85	0	62,000	0
188	AL	556	ROANOKE TELEPHONE COMPANY INC	ROANOKE AL 36274	03/11/85	1,865,850	1,793,000	0
189	AZ	509	NAVAJO COMMUNICATIONS CO INC	GRANDVIEW TX 76050	03/11/85	0	0	21,139,000
190	WI	539	MOSINEE TELE COMPANY	MOSINEE WI 5445	03/13/85	0	151,751	0
191	CO	531	THE BLANCA TELEPHONE COMPANY	ALAMOSA CO 81101	04/09/85	0	283,726	0
192	GA	506	CITIZENS TELEPHONE CO INC	LESLIE GA 31764	04/09/85	0	168,102	0

193	SC	535	MC CLELLANVILLE TELE CO INC	LEESBURG AL 35983	04/09/85	0	80,000	0
194	WI	536	HEADWATERS TELEPHONE CO	RHINELANDER WI 54501	04/09/85	0	509,991	0
195	NC	543	BARNARDSVILLE TELEPHONE CO	LEESBURG AL 35983	04/10/85	0	36,000	0
196	IN	522	PERRY SPENCER RUR TEL COOP INC	ST MEINARD IN 47577	04/23/85	875,700	0	0
197	IN	522	PERRY SPENCER RUR TEL COOP INC	ST MEINARD IN 47577	04/23/85	0	22,000	0
198	AR	530	TRI COUNTY TELE COMP INC	EVERTON AR 72633	04/29/85	0	1,999,000	0
199	MS	501	DECATUR TELEPHONE COMPANY INC	DECATUR MS 39327	04/29/85	0	412,396	0
200	TX	609	VALLEY VIEW TELE CO	MUENSTER TX 76252	04/29/85	0	95,000	0
201	MT	525	LINCOLN TELEPHONE COMPANY	LINCOLN MT 59639	05/06/85	0	22,000	0
202	WI	633	AMHERST TELEPHONE COMPANY	AMHERST WI 54406	05/06/85	0	374,000	0
203	IA	574	MASSENA TELE COMPANY	MASSENA IA 50853	05/21/85	0	44,591	0
204	IA	510	WINNEBAGO COOP TELEPHONE ASSN	LAKE MILLS IA 50450	05/22/85	800,261	0	0
205	TX	633	GANADO TELEPHONE COMPANY	GANADO TX 77962	05/22/85	0	426,000	0
206	AL	546	HAYNEVILLE TELEPHONE CO INC	HAYNEVILLE AL 36040	06/05/85	0	186,945	0
207	IA	602	CENTRAL SCOTT TELE COMPANY	ELDRIDGE IA 52748	06/05/85	0	2,487,387	0
208	MT	511	NEMONT TELEPHONE COOP INC	SCOBEY MT 59263	06/05/85	0	22,000	0
209	MT	517	BLACKFOOT TELEPHONE COOP INC	MISSOULA MT 59802	06/05/85	2,145,150	0	0
210	MT	517	BLACKFOOT TELEPHONE COOP INC	MISSOULA MT 59802	06/05/85	0	460,000	0
211	AR	534	LAVACA TELEPHONE COMPANY INC	LAVACA AR 72941	06/17/85	301,665	0	0
212	MT	518	RANGE TELE COOP INC	FORSYTH MT 59327	06/17/85	0	2,460,249	0
213	TX	507	WEST TEXAS RUR TEL COOP INC	HEREFORD TX 79045	06/17/85	108,596	0	0
214	NC	539	ELLERBE TELE COMPANY INC	ELLERBE NC 28338	06/20/85	0	174,000	0
215	ID	513	ROCKLAND TELEPHONE CO INC	ROCKLAND ID 83271	06/21/85	0	138,579	0
216	MN	611	BRIDGE WATER TELE CO	MONTICELLO MN 55362	06/21/85	12,075	0	0
217	SD	532	TRI COUNTY MUTUAL TEL CO	EMERY SD 57332	06/21/85	[illegible]	181,320	0
218	WI	598	MONDOVI TELE CO	MONDOVI WI 54755	06/21/85	0	36,525	0
219	KY	541	SALEM TELEPHONE COMPANY INC	SALEM KY 42078	07/24/85	0	7,000	0
220	KY	541	SALEM TELEPHONE COMPANY INC	SALEM KY 42078	07/25/85	0	0	0
221	AL	504	FLORALA TELEPHONE CO INC	FLORALA AL 36442	08/09/85	206,850	0	0
222	OK	543	CIMARRON TELEPHONE COMPANY	MANNFORD OK 74044	08/13/85	0	817,000	0
223	SC	538	FORT MILL TEL CO	FORT MILL SC 29715	09/16/85	855,630	0	0
224	NE	554	CENTRAL NEBRASKA TEL CO	BLAIR NE 68008	09/17/85	375,930	0	0
225	NE	554	CENTRAL NEBRASKA TEL CO	BLAIR NE 68008	09/17/85	908,250	0	0
226	GA	543	COASTAL UTILITIES INC	HINESVILLE GA 31313	09/20/85	1,073,485	0	0
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FY				FY 1985 Total		19,442,332	24,732,006	60,984,000

--- FISCAL YEAR =1986 ---

OBS	STATE NAME	BORR NUMBER	BORROWER NAME	CITY STATE ZIP	RECISION DATE	RURAL TELEPHONE BANK LOAN	REA INSURED LOAN	GUARANTEED LOAN
227	TN	502	ALLTEL TENNESSEE INC	LITTLE ROCK AR 72203	10/08/85	945,000	0	0
228	TX	612	PALO PINTO TELEPHONE COMPANY	TYLER TX 75710	11/04/85	1,044,750	0	0
229	TX	612	PALO PINTO TELEPHONE COMPANY	TYLER TX 75710	11/04/85	3,785,250	0	0
230	MT	510	VALLEY RUR TEL COOP ASSN INC	GLASGOW MT 59230	11/14/85	0	366,000	0

231	SD	535	SIOUX VALLEY TELEPHONE CO	DELL RAPIDS SD 57022	11/14/85	0	62,657	0
232	WI	606	COCHRANE COOP TELEPHONE CO	COCHRANE WI 54622	11/14/85	163,800	0	0
233	OH	509	SHERWOOD MUTUAL TEL ASSN INC	SHERWOOD OH 43556	11/15/85	139,125	0	0
234	GA	513	STANDARD TELEPHONE CO	CORNELIA GA 30531	11/22/85	0	3,988,000	0
235	PA	544	BETHEL AND MT AETNA TEL & TEL CO	WESTFIELD IN 46074	11/22/85	3,068,100	0	0
236	SC	533	POND BRANCH TELE CO INC	GILBERT SC 29054	11/22/85	1,866,900	0	0
237	SC	533	POND BRANCH TELE CO INC	GILBERT SC 29054	11/22/85	0	332,162	0
238	TN	547	BEN LOMAND RUR TEL COOP INC	MCMINNVILLE TN 37110	11/22/85	0	3,826,000	0
239	SC	506	WEST CAROLINA RUR TEL COOP INC	ABBEVILLE SC 29620	11/26/85	0	521,558	0
240	MI	532	HADLEY TELEPHONE CO INC	MONROE LA 71211	01/17/86	492,208	0	0
241	MS	510	GLEN ALLAN TELE CO	GLEN ALLAN MS 38744	01/27/86	0	58,000	0
242	PA	510	SALTILLO TELE COMPANY	CARLISLE PA 17013	01/27/86	282,450	390,000	0
243	MI	536	ALLTEL MICHIGAN INC	STOCKBRIDGE MI 49285	01/31/86	1,518,300	0	0
244	MI	536	ALLTEL MICHIGAN INC	STOCKBRIDGE MI 49285	01/31/86	13,860,000	0	0
245	TX	517	SOUTH PLAINS TEL COOP INC	LUBBOCK TX 79408	02/11/86	0	1,381,000	0
246	WI	598	MONDOVI TELE CO	MONDOVI WI 54755	02/24/86	0	8,263	0
247	IL	513	MCDONOUGH TEL COOP INC	COLCHESTER IL 62326	03/18/86	676,200	0	0
248	NY	533	CASSADAGA TELEPHONE CORP	FREDONIA NY 14063	03/18/86	0	278,000	0
249	WI	605	VIROQUA TELEPHONE CO	VIROQUA WI 54665	03/18/86	865,200	0	0
250	IL	572	THE EL PASO TELEPHONE COMPANY INC	EL PASO IL 61738	04/04/86	226,655	0	0
251	IA	524	ROCKWELL COOP TELEPHONE ASSN	ROCKWELL IA 50469	04/04/86	505,575	0	0
252	WI	562	RIB LAKE TELEPHONE CO	RIB LAKE WI 54470	04/04/86	420,000	0	0
253	TX	592	COLO VALLEY TELE COOP INC	LA GRANGE TX 78945	05/08/86	3,227,700	342,000	0
254	LA	515	CAMERON TELEPHONE COMPANY	SULPHUR LA 70663	05/21/86	3,598,974	0	0
255	KS	575	SOUTHERN KANSAS TEL CO INC	CLEARWATER KS 67026	06/06/86	2,441,250	0	0
256	AL	536	UNION SPRINGS TELE CO INC	UNION SPRINGS AL 36089	06/16/86	870,000	0	0
	VT	504	PERKINSVILLE TELEPHONE CO INC	NORTHFIELD VT 05663	06/16/86	309,750	0	0
	OK	550	PINE TELEPHONE CO	BROKEN BOW OK 74728	06/24/86	1,494,150	0	0
	IL	511	MID CENTURY TEL COOP	CANTON IL 61520	07/16/86	986,160	0	0
	IA	522	NORTH CENTRAL TELEPHONE CO	BADGER IA 50516	07/16/86	0	19,758	0
	VT	505	NORTHFIELD TELEPHONE COMPANY	NORTHFIELD VT 05663	07/16/86	1,082,898	0	0
	IA	563	COOPERATIVE TELEPHONE CO	VICTOR IA 52347	09/05/86	358,050	0	0
	NH	507	MERIDEN TELEPHONE CO. INC.	NORTHFIELD VT 05663	09/10/86	360,412	0	0
	NY	550	SENECA GORHAM TELEPHONE CORP	HOLCOMB NY 14469	09/22/86	2,176,650	0	0
				FY 1986 Total		46,765,507	11,573,398	0

FISCAL YEAR =1987

STATE NAME	BORR NUMBER	BORROWER NAME	CITY STATE ZIP	RECISION DATE	RURAL TELEPHONE BANK LOAN	REA INSURED LOAN	GUARANTEED LOAN
MN	552	REDWOOD COUNTY TELE CO	REDWOOD FALLS MN 56283	11/18/86	1,185,135	0	0
CA	541	EVANS TELEPHONE COMPANY	TURLOCK CA 95380	11/19/86	488,985	0	0
PA	555	PALMERTON TELEPHONE COMPANY	PALMERTON PA 18071	12/11/86	2,258,550	0	0
WI	590	WEYAUWEGA TELEPHONE COMPANY	WEYAUWEGA WI 54983	01/07/87	117,957	0	0
WI	641	CENCOM OF WISCONSIN INC	RUSHFORD MN 55971	01/07/87	3,452,400	0	0
IA	608	RIVER VALLEY TELE COOP	GRAETTINGER IA 51342	02/02/87	322,350	0	0
			FY 1987 Total		7,825,377	0	0
			FY 1981 - March 1987 Total		108,297,836	63,756,285	110,843,000

Question: You have failed for three consecutive fiscal years to meet the minimum established loan levels for the telephone program.

Shouldn't you be doing everything possible to expedite loan processing rather than slowing it down?

Answer: We are continuing to update procedures that enable us to process loans on a timely basis. We have had few, if any, complaints from borrowers about the length of loan processing time. The number and amount of loan applications on hand at the end of a fiscal year have declined dramatically over the past few years.

For example, at the end of fiscal year 1986 there were only 20 completed applications on hand for $117,887,000. One of these loan applications, for $52,000,000, could have been approved during 1986 had the borrower promptly accepted the loan. The 20 completed applications compare with 96 completed applications on hand at the end of fiscal year 1983 for $425,000,000.

NEW LOANS

Question: For the record, I would like to have some information on the status of the REA lending activity.

What is the number and what are the amounts of REA loan guarantees approved this fiscal year?

Answer: As of March 31, 1987, one loan guarantee has been approved in the amount of $38,135,000 for an electric borrower.

Question: What is the number and what are the amounts of loan guarantee applications at REA?

Answer: As of April 4, 1987, there are ten (10) electric loan applications on hand in the amount of $270,505,906. There are no applications on hand for guaranteed telephone loans.

Question: Please list the applicants, the amount and purpose for each of the loans.

Answer: The information will be provided for the record. [The information follows:]

Applicants for Guaranteed Loans

Central Iowa Power Cooperative Cedar Rapids, IA New transmission facilities	$6,385,000
Western Illinois Power Cooperative, Inc. Jacksonville, IL New transmission facilities	347,000

Associated Electric Cooperative, Inc. Springfield, MO	
New transmission and system improvements	33,000,000
Central Electric Power Cooperative Jefferson City, MO	
New transmission substations and SCADA equipment	4,753,000
Tri State G&T Association Denver, CO	
Bulk transmission facilities	53,178,906
South Mississippi Electric Power Association Hattiesburg, MS	
Energy management control system	3,450,000
Bulk transmission	10,403,000
Headquarter service facility for EMC system	244,000
United Power Association Elk River, MN	
Generation & transmission system improvements	2,207,000
Sunflower Electric Cooperative, Inc. Hays, KS	
Deficiency of Holcum Generating Plant	24,473,000
Brazos Electric Power Cooperative Waco, TX	
Deficiency of Commanche Peak Nuclear Plant	55,500,000
Tex-La Electric Cooperative of Texas, Inc. San Augustine, TX	
Deficiency of Commanche Peak Nuclear Plant	76,565,000
Total	$270,505,906

Question: How many of these loans do you expect to approve this year? Which ones?

Answer: It is inappropriate to state which loans will be made before the loan processing procedure is complete and the final loan documentation is presented to me for consideration of approval.

All of these loans are currently being processed by the area offices.

ASSET SALES

Question: The President proposes total sales of $1 billion of direct loan assets in fiscal year 1988 from the Rural Electric and Telephone Revolving Fund, and $500 million from the Rural Telephone Bank. Have you evaluated the cost of this asset sale in terms of interest and principal payments that the government will have to forego in 1988 and later years?

Answer: The sale of REA loan assets will result in prepayment of principal to the revolving fund and the Rural Telephone Bank (RTB). We expect to use these receipts to redeem outstanding Treasury and FFB debt of the revolving fund and to allow the RTB to repay borrowing from Treasury and repurchase Class A Stock. By redeeming outstanding debt, the interest expense will be reduced in 1988 and later years. Asset sales will result in less future income to the Agency.

Question: Have you evaluated the marketability of loan assets and the potential net proceeds from their sale?

Answer: The estimated net proceeds from the revolving fund and Rural Telephone Bank loan asset sales are included in the budget proposal. Marketing of loan assets would be supervised by a Financial Advisor. The Agency advertised for an advisor, but withdrew its request when Section 306(B), Sale or Prepayment of Direct or Insured Loans, of the Rural Electrification Act of 1936, as amended, was enacted.

Question: How much will you have to discount the loans in order to sell them?

Answer: The loans would be discounted to present value. Each sale would undoubtedly be somewhat different as the present value would change with the changing interest rates.

Question: The Budget Reconciliation Act of last year mandated that REA allow $2.0175 billion of long-term Federal Financing Bank debt to be prepaid by REA borrowers using private capital. The Act also allowed REA borrowers to "buy back" their insured loans from the REA revolving fund at a discount. Meanwhile, the Administration has proposed selling loan assets. Do you consider the reconciliation provisions to be "asset sales?"

Answer: The Omnibus Budget Reconciliation Act of 1986, in Section 306B entitled "Sale or Prepayment of Direct or Insured Loans" requires that direct or insured loans shall not be sold or prepaid at a value less than the face value of any outstanding principal balance except when sold to or prepaid by the borrower. We interpret the reconciliation provisions as an opportunity for interested borrowers to prepay their REA loans and be free of Federal funding restrictions in order to diversify their operations. We do not consider prepayments to be asset sales.

Question: What is the difference between allowing the insured loans to be bought back by the borrower at a discount and the guaranteed loans to be prepaid 100 cents on the dollar?

Answer: The difference in these prepayment programs arises from the difference in the language contained in the Omnibus Budget Reconciliation Act of 1986.

For REA direct and insured loans, a present value mechanism is expressly authorized. In the accompanying legislative history, the discount rate to be used is specifically stated as the cost of money to a double A rated utility. Using this mechanism, as long as the double A rate is more than a borrower's weighted average rate on REA loans, REA will receive less than the face value of the outstanding loans.

The authorizing legislation for prepayment of REA guaranteed Federal Financing Bank (FFB) loans specifically calls for a borrower to pay the outstanding principal balance. Borrowers are allowed to make this payment without the prepayment penalty called for in the initial loan contract with the FFB.

Question: Last Year, REA advertised in the Wall Street Journal to contract for a financial advisor. Has the Agency completed such a contract?

Answer: REA did not enter into a contract with a financial advisor because the provisions of Section 306(B), Sale or Prepayment of Direct or Insured Loans, of the Rural Electrification Act of 1936, as amended, did not allow for the sale of assets at less than face value of any outstanding principal balance except when sold to a borrower.

Question: If yes, how much has been spent on this contract?

Answer: No contract was let by the Agency.

Question: What advice has the Agency received?

Answer: No financial advice has been provided to the Agency through contractual agreement.

Question: Who is the advisor?

Answer: REA has not retained the services of a financial advisor.

Question: Please explain what specific actions REA has taken in the last six months to attempt to sell REA loans to entities other than REA borrowers?

Answer: REA has not taken any specific actions in the last six months to sell loan assets from the revolving fund or the Rural Telephone Bank to entities other than REA borrowers.

LOAN LEVELS

Question: The President's budget for fiscal year 1988 calls for a drastic cut in the REA telephone and electric loan programs along with an increase in direct loan interest rates from 5 percent to the current treasury rate plus 1/8th of a percent. Of significance is the 87 percent cut in the telephone loans and 59 percent cut in electric loans.

At a time when future revenues of small independent telephone companies are seriously impacted by deregulation of the telephone industry and at a time when the rural farm economy is suffering, I cannot understand why you would recommend eliminating these sources of affordable financing?

Answer: The fiscal year 1988 funding request for the REA telephone insured loans, Rural Telephone Bank and telephone guarantees was targeted to meet the anticipated need for loan funds in the telephone program. The number of applications and amount of funding used by telephone borrowers has been declining. We anticipate being able to meet the funding requests of REA borrowers within the amounts budgeted.

REA telephone borrowers are financially healthy and currently can qualify for private credit at very competitive interest rates. The budget proposal would eliminate telephone loans to subsidiaries of large telephone holding companies. This would make loan funds available to rural telephone companies that are in continuing need of government funds.

Question: This proposal accelerates the Administration's proposed termination of the direct loan program and the Rural Telephone Bank program, and replaces these invaluable loan programs with a new program of privately originated loans with an REA guarantee of only 70 percent of the loan principal to "ensure that private credit will meet their needs." The net worth of REA telephone borrowers averages 30 percent of total assets as compared with the 42-50 percent debt/equity ratio that the private market requires of phone systems.

How do you propose that these borrowers suddenly have the fiscal capacity to qualify for commercial loans?

Answer: Lenders are interested in the borrowers' ability to repay their loans rather than their ratio of equity to debt. REA borrowers have had an excellent earnings history over the past several years. From 1980 to 1985, net earnings increased by $275,645,000, or 127 percent.

Most REA borrowers do have a strong debt/equity position. The excellent financial health of REA borrowers makes them attractive candidates for private sector loans. The REA loan program is being continued for those borrowers who cannot qualify for private credit.

GENERAL

Question: I notice in your Brief History of the Rural Electric and Telephone Programs under the chronology of legislative changes, you do not list the Supplemental Appropriations Bill for Fiscal Year 1986 which contained the initial prepayment legislation.

Why is that not listed in this document?

Answer: Public Law 99-349, the Urgent Supplemental Appropriations Act of 1986 did contain the initial prepayment legislation. This act was amended by P.L. 99-509, the Omnibus Budget Reconciliation Act of 1986, which struck out the provisions relating to the prepayment of loans by rural electrification and telephone systems.

Question: Your proposal contains loans from the private sector with a 70 percent government guarantee. At the same time, you state that this will allow borrowers to obtain capitalization from private sources without substantially reducing any risk. Do you have any reason to believe that they will be able to get these loans from the private sector with only a 70 percent guarantee?

Answer: Private lenders have expressed a continuing interest in providing funds to REA borrowers. I have received many inquiries from banks, brokerage firms, and attorneys representing interested parties about the possibility of loaning funds to our borrowers with a government guarantee. Recent legislation authorized the Bank for Cooperatives to lend funds to all REA borrowers regardless of whether or not they are cooperatives or what percentage of their consumers or subscribers are farmers. In addition, National Rural Utilities Cooperative Finance Corporation (CFC) has expressed an interest in providing more loan funds to our borrowers. This strong interest indicates to me that the borrowers will not have difficulty in obtaining funds when the new guaranteed program proposed in the budget is in place.

Question: In the Farmers Home Administration program, we've seen that a 90 percent guarantee does not bring the private lenders forward to participate. What makes you think that a 70 percent guarantee in the REA program will do the trick?

Answer: I believe the reason why REA will be able to obtain private sector financing with a 70 percent guarantee has to do with the purpose for which the loan is made. The farmer is hurting because farm income is down and farm land is not as strong security as it was in the past. Nevertheless, the Farmers Home Administration's guaranteed program has increased substantially over the past few years.

I believe REA will be able to obtain private sector financing because REA borrowers have grown into prospering businesses. Many of them are solvent and have a good flow of revenue. These qualities make them attractive to private sector financiers.

Question: You state that in constant dollars, rural electric consumers pay far less for electricity today than they paid 35 years ago. What I want to know is what do rural electric consumers pay for electricity compared to their counterparts who receive electricity through investor-owned utilities?

Answer: An analysis of typical residential electric bills at 1,000 kilowatt hours using January 1, 1986, data for 919 REA electric borrowers indicated that 71.6% had a higher bill than the comparable investor-owned utility. However, only 39.9% of the borrowers had a bill that was $10.00 or more higher than the comparable investor-owned utility. Using January 1, 1985, data, 75.8% of REA borrowers had a higher bill.

Question: Has the Rural Electrification Administration considered refinancing its certificates of beneficial ownership to the Federal Financing Bank in order to reduce the interest costs to the Rural Electrification and Telephone Revolving Fund?

Answer: Due to terms included in the agreement for purchase of Certificates of Beneficial Ownership (CBO), signed by the Federal Financing Bank and the Rural Electrification Administration (REA), there is no economic advantage for REA to refinance its outstanding CBO's.

SUBSIDY COSTS

Question: You claim that the direct subsidy cost to the taxpayers of all REA programs since 1973 is $17.7 billion, and that the total economic subsidy to all REA borrowers since 1973 is $53.1 billion.

Would you please break these amounts down for each of the years since 1973?

Answer: The following tables reflect the direct subsidy and the economic subsidy costs of direct loans made from the Rural Electric and Telephone Revolving Fund (RETRF) and the Rural Telephone Bank (RTB) since fiscal year 1973.

RETRF Insured Loans
(Dollars in Millions)

Fiscal Year	Direct Subsidy 1/	Economic Subsidy 2/
1973	$ 59.7	$ 102.5
1974	561.2	1,049.2
1975	497.0	1,247.1
1976	783.6	1,584.7

Transition Quarter - (TQ) 3/		
1977	690.7	1,257.6
1978	748.7	1,208.1
1979	1,364.0	1,928.5
1980	1,840.0	3,171.1
1981	2,934.2	4,092.9
1982	2,404.9	3,354.3
1983	1,524.1	2,080.0
1984	1,516.0	2,105.0
1985	1,283.3	1,719.3
1986	1,181.3	1,213.6
Total	$17,388.7	$26,113.9

1/ Calculated on the Treasury cost-of-money rate.
2/ Calculated on Moody's Aa public utility rate.
3/ For purposes of this calculation, one-half of the TQ advances were added to FY 1976 and the other one-half were added to FY 1977.

RTB Loans
(Dollars in Millions)

Fiscal Year	Direct Subsidy 1/	Economic Subsidy 2/
1973	$ -0.3	$ 20.6
1974	16.3	76.3
1975	-46.5	67.5
1976	-29.3	57.0
Transition Quarter - (TQ) 3/		
1977	-4.4	47.7
1978	32.8	107.0
1979	36.9	103.6
1980	67.7	288.2
1981	77.1	220.1
1982	24.0	125.6
1983	11.4	72.1
1984	47.8	116.0
1985	27.1	66.8
1986	19.9	22.3
Total	$280.5	$1,390.8

1/ Calculated on the Treasury cost-of-money rate.
2/ Calculated on Moody's Aa public utility rate.
3/ For purposes of this calculation, one-half of the TQ advances were added to FY 1976 and the other one-half were added to FY 1977.

Guaranteed Loans

Information is not available to relate the subsidies on loan guarantee commitments to a particular year. Because borrowers under REA loan guarantee commitments have had the option to draw advances of funds on a short-term basis and roll advances over several times at different interest rates, our subsidy estimates on the guaranteed loans were prepared on an actual advance by advance basis. Consequently, we are not able to relate the advance amounts back to a particular year's loan totals. We estimate that the nominal value of the economic subsidy that will be realized over the life of the loan funds advanced from Fiscal Years 1975 to 1987 is $25,546.2 million.

QUESTIONS SUBMITTED BY SENATOR STENNIS

ELECTRIC AND TELEPHONE PROGRAM

Question: As I understand it, one of the original purposes of the Rural Electrification Administration was to help provide electricity in rural areas where the "customer-per-mile" density was too small to be economically feasible. Later, because of that same problem, I played a role in getting rural telephone cooperatives added to the system for obtaining loans.

There are about 1,000 rural electric cooperatives nationwide. Can you tell me the average customer per mile for those cooperatives and compare it to that of urban power companies? Also, I would like to know the average revenue per mile for the two.

Answer: The average customer per mile for REA electric borrowers is 5.45 and the revenue per mile is $6,370.88. Comparable data for investor-owned utilities are not published; however, they are generally considered to have a density in excess of 30 consumers per mile.

Question: Please make the same comparison between rural and urban telephone companies.

For telephone borrowers, average density is 6.80 customers per mile and average revenue per route mile of line is $4,654.29. We have not been able to make comparisons with other telephone companies because REA borrowers report linear miles, whereas most other telephone companies report square miles. A figure generally used by the telephone industry is that the Bell Operating Companies have a density in excess of 40 customers per route mile of line.

QUESTIONS SUBMITTED BY SENATOR SASSER

CAPITAL RESERVES AND ELIGIBILITY

Question: For some time now, REA has been moving toward a proposal to deny eligibility to REA borrowers who maintain more than 5 percent of their general funds. The cooperatives in my state tell me that 5 percent is simply too low to maintain financial stability.

What basis does REA have for lowering the percentage from eight to five?

Answer: Currently REA is prohibited from using any level of general funds in analyzing a borrower's request for a loan or loan advance. In testifying on the FY 1986 Budget, we proposed using a working capital method instead of the general funds policy. This proposal was a result of a 1983 audit report of REA loan policies and procedures by the Office of the Inspector General and would result in a working capital level of 5 percent of total utility plant as adequate for borrower operations.

Question: What basis does REA have for asserting that REA borrowers who are above 5 percent will be able to obtain credit in the commercial market?

Answer: Many of our borrowers are enjoying the best financial health in many years and would qualify for private sector loans. However, it was not our intention to exclude borrowers whose adjusted working capital levels exceed 5 percent of total utility plant. We estimate that, after a short adjustment period, a typical borrower would be in conformance and participating in REA loan programs.

QUESTIONS SUBMITTED BY SENATOR BUMPERS

RURAL TELEPHONE BANK INTEREST RATE

Question: Mr. Hunter, I understand that REA-proposed rules were recently published in the Federal Register which would allow future Rural Telephone Bank borrowers to be charged interest based on the cost of money to the RTB at the time of draw downs from their loans, whereas existing borrowers must continue to pay interest on draw downs based on the cost of money to the RTB at the time of the loan's origination. The RTB has actively sought policy changes which would ensure that the cost of money at the time of draw down would determine the interest rate on that advance to a borrower, but believes that this should apply to both current and future borrowers. Why don't you agree that this change in policy, which is consistent with the law, should be applied equally to current, as well as future, borrowers from the Rural Telephone Bank?

Answer: The Board of Directors of the Rural Telephone Bank adopted a resolution in September 1986 directing the RTB staff to publish a proposed rule to accomplish this end. The rule was sent forward for review under Executive Order 12291. It was returned to REA in early December because the borrower's option of retroactively switching from their fixed rate loans to a changing rate did not comport with Section 1 (b) of Executive Order 12291 which requires the regulation's potential benefits to outweigh the potential costs to society.

CONSUMER RATES

Question: The benefits of the REA loan programs are significant for rural customers. Many REA borrowers cannot afford to pay commercial interest rates. If the REA direct loan programs are eliminated, these borrowers will face higher rates which will be passed along through rate increases to the consumers. With the rural economy in such trouble, I find it hard to justify such increases for consumers of electric and telephone services. Would you comment?

Answer: Currently private sector interest rates are very competitive and many of the REA borrowers are financially healthy. For the average REA borrower, interest costs are only a small percentage of total operating costs. Thus, changes in interest rates have a relatively small effect on total operating costs and on the ratepayers.

Using a range of interest rates from 5.3 percent to 9.3 percent, we have estimated that for each increase of 1 percentage point in the REA rate, there would be a resulting increase of approximately 12 cents per month to the average residential consumer.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

BUDGET REFORM

Question: Calls for budget reform are increasingly heard as budget deadlines are too often missed, important budget decisions are delayed, appropriation bills and other direct spending legislation are held up in committee, and omnibus spending bills take the place of timely and orderly consideration of individual bills. One procedural reform that is being considered is the two-year budget cycle where budget and appropriation matters would be considered in the first year, and authorizations and oversight would be undertaken in the second year.

Would your department/agency favor a biennial budget process? What benefits would your agency achieve in a two-year appropriation cycle?

Answer: REA would be in favor of a biennial budget process. Policy officials could spend more time dealing with substantive issues and there would be more opportunity for improved program management. There would be substantial savings in budget submission paperwork. The Agency would receive intangible benefits as a result of more predictable and stable funding levels.

Question: Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer: Funding needs for REA's loan programs and Salaries and Expenses are relatively predictable and could be handled on a two-year basis.

Question: What difficulties can you foresee in preparing and submitting a two-year budget to the Congress?

Answer: The Rural Electric and Telephone Revolving Fund and the Rural Telephone Bank have the authority to borrow from the Treasury and therefore can meet their cash requirements without Congressional action. However, conditions may require changes in the authority levels from new loans which require Congressional action.

Question: Would you expect to realize any budget savings if you could plan your agency budget on a two-year basis? If so, could you estimate how much?

Answer: REA would not expect to realize any material savings if the formulation of the President's budget were done on a two-year cycle, as proposed, rather than an annual basis. REA's headquarters organization is structured to operate with the minimum essential staff to perform its overall functions and responsibilities.

Question: If you oppose the biennial budget concept, please give this subcommittee your reasons why.

Answer: REA has no objection to the biennial budget concept.

SUBCOMMITTEE RECESS

Senator BURDICK. This concludes today's hearing. We appreciate your having been here today to share with us your views on the fiscal year 1988 appropriation for the Department of Agriculture.

Our next hearing will be held Tuesday, March 31, in this same room, beginning at 10:00 a.m. At that time we will hear from representatives of the Foreign Agricultural Service and the Office of International Cooperation and Development. Until then, this subcommittee stands in recess.

[Whereupon, at 11:23 a.m., Wednesday, March 25, the subcommittee was recessed, to reconvene at 10 a.m., Tuesday, March 31.]

AGRICULTURE, RURAL DEVELOPMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 1988

TUESDAY, MARCH 31, 1987

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10 a.m. in room SD-138, Dirksen Senate Office Building, Hon. Quentin N. Burdick (chairman) presiding.

Present: Senators Burdick, Cochran, and Grassley.

DEPARTMENT OF AGRICULTURE

FOREIGN AGRICULTURAL SERVICE

STATEMENTS OF:

- **DANIEL G. AMSTUTZ, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS AND COMMODITY PROGRAMS**
- **THOMAS O. KAY, ADMINISTRATOR, FOREIGN AGRICULTURAL SERVICE**

ACCOMPANIED BY:

- **LEO V. MAYER, ASSOCIATE ADMINISTRATOR, FOREIGN AGRICULTURAL SERVICE**
- **JOHN W. WILLIAMS, DIRECTOR, BUDGET AND FINANCE DIVISION, FOREIGN AGRICULTURAL SERVICE**
- **ROBERT E. SHERMAN, DEPUTY BUDGET OFFICER, DEPARTMENT OF AGRICULTURE**

INTRODUCTION OF WITNESSES

Senator BURDICK. The subcommittee will please come to order.

This morning we are continuing our hearings on the administration's proposed fiscal year 1988 budget for the Department of Agriculture. Under Secretary for International Affairs and Commodity Programs, Mr. Daniel Amstutz; Administrator of the Foreign Agricultural Service, Mr. Thomas Kay; Administrator of the Office of International Cooperation and Development, Dr. Joan Wallace; and Mr. Melvin Sims, General Sales Manager, will present testimony on foreign agriculture programs. Bob Sherman, Deputy Budget Officer for the Department, also joins us.

INTRODUCTORY REMARKS

Significant declines in U.S. exports over the past several years have prompted new and expanded initiatives to improve agricultural trade. Although many reasons have been cited for the drop in the overall U.S.

trade balance, agricultural exports continue to outpace agricultural imports. Still, lawmakers, farmers, investors, public and private sector interests, together are seeking ways to increase U.S. access to new markets by removing trade barriers, fostering market development, and encouraging a steady flow of U.S. commodities to underdeveloped and developing nations.

The 1985 Food Security Act established and reinforced export activities through 12 major programs managed by the Foreign Agricultural Service. In large part, the effectiveness of these programs can be measured by the improved position of the United States in the world marketplace. Yet, there remains a great deal of room for progress.

While there are many factors that contribute to the U.S. agricultural trade position, including competition from newly developing countries, the efforts of the Foreign Agricultural Service in promoting U.S. exports should be commended.

As we discuss the fiscal year 1988 budget proposals today, we will be interested to learn what projections FAS has for improving our trade balance, and increasing export development and how the fiscal year 1988 budget proposed by the administration is designed to attain these objectives.

In addition, the Office of International Cooperation and Development offers unique opportunities for sharing information, research and expertise in agriculture. Through collaborative and exchange programs between the United States and foreign nations, the OICD plays an important role in shaping international agricultural development.

It is a pleasure to welcome our representatives from the USDA today to discuss ongoing projects and those planned for fiscal year 1988. Welcome, ladies and gentlemen. You may proceed in the order you wish.

STATEMENT OF MR. AMSTUTZ

Mr. AMSTUTZ. Thank you, Mr. Chairman.

It is a pleasure for us to be with you and the subcommittee today to discuss the Foreign Agricultural Service and the Office of International Cooperation and Development.

In an attempt to be time conscious, I would just like to submit my brief statement for the record, Mr. Chairman, and then call on my colleagues for their statements, if that is satisfactory to you.

PREPARED STATEMENT

Senator BURDICK. Your statement and all the statements of the witnesses will be made a part of the record in full.

Mr. AMSTUTZ. Thank you.

Senator BURDICK. So you may abbreviate.

Mr. AMSTUTZ. Thank you.

[The statement follows:]

STATEMENT OF DANIEL G. AMSTUTZ

Mr. Chairman, Members of the Committee, I am pleased to be with you again this morning and to have the opportunity to discuss with you the fiscal 1988 budget proposals for the international programs and agencies of the Department.

For this discussion, I am accompanied today by Tom Kay, the Administrator of the Foreign Agricultural Service (FAS), Melvin Sims, the General Sales Manager, and Joan Wallace, the Administrator of the Office of International Cooperation and Development (OICD).

Each of the Administrators has a prepared statement providing details on the various budget and program proposals for fiscal 1988. Before moving to their statements, I would like to make some introductory remarks about our proposals.

Mr. Chairman, I think we all agree that exports are of critical importance to American agriculture. We at the Department of Agriculture continue to devote a substantial portion of our attention and efforts to achieving gains in the export area. Provisions of the Food Security Act of 1985 have laid the groundwork for increased U.S. competitiveness in the international marketplace, and subsequent developments, such as the recent decline in the value of the dollar relative to other currencies, are also contributing to our improved position. Already during 1987, we expect to see increases in export volume and our agricultural trade balance, and we believe these gains will continue in the future.

Our fiscal 1988 budget proposals reflect our commitment to agricultural exports. However, they are also tempered by our objective of reducing the Federal budget deficit and meeting the deficit reduction targets of the Gramm- Rudman-Hollings Act. In some cases, we have had to make difficult choices among programs.

For CCC export credit, we are proposing program levels for short- and intermediate-term export credit guarantees which we believe are realistic and can be used effectively. While this entails a reduction in short-term credit guarantees from the level mandated by the Food Security Act, it more accurately reflects recent levels of annual sales activity in the program. Moreover, we will be carrying out a wide range of other export promotion activities during 1988, including the Export Enhancement Program, which will allow for this reduction in the program level for short-term credit guarantees.

For P.L. 480 food assistance, we are proposing a program level which should provide for the shipment of approximately 7.8 million metric tons of commodities -- near the level of the past several years. Additional volumes of food assistance are expected to be provided through Section 416 authority, providing commodities from CCC stocks for donation overseas.

For the Foreign Agricultural Service, we are requesting a program level which will continue the agency's activities near current levels. Included in the FAS proposal is a request for funding for the foreign market development cooperator program during 1988 at the same level as that enacted for 1987. Additional market development assistance will be provided through the Targeted Export Assistance Program although we are proposing a somewhat reduced level for this activity.

The workload of the Office of the General Sales Manager (OGSM) has increased greatly as a result of the export provisions of the Food Security Act. In response, we have submitted a supplemental funding request for fiscal 1987 which will provide for a modest expansion in staff to ensure these programs are carried out efficiently and effectively. This additional funding has also been incorporated into the request for fiscal 1988 funding for OGSM.

Our request for the Office of International Cooperation and Development continues most activities near current levels. OICD's technical assistance and training activities in developing countries, which are funded on a reimbursable basis by the Agency for International Development and others, are also expected to continue in fiscal 1988 at the current 1987 level. Several program reductions are proposed due to deficit reduction considerations. The Middle Income Training Program, and the Special Foreign Currency Research Program will be phased out. Due to the very limited availability of excess foreign currencies, the Administration is requesting no further funding in any of the special foreign currency programs in fiscal 1988.

Mr. Chairman, that concludes my remarks. I would be pleased to answer any questions you may have.

STATEMENT OF MR. KAY

Mr. AMSTUTZ. I will call now on Mr. Kay.

Mr. KAY. Mr. Chairman, members of the subcommittee, I appreciate the opportunity to meet with you to discuss the work of the Foreign Agricultural Service and to present our budget for fiscal year 1988.

With your approval, I will also submit my complete statement for the record, but I would briefly like to highlight the progress we are making to improve our food and fiber exports.

FAS is attacking the situation from a number of fronts. We are aggressively fighting to protect and increase market access for U.S. agricultural products.

RESULTS OF TRADE NEGOTIATIONS

We reported a major breakthrough with the European Community in the impasse we had reached over the accession of Spain and Portugal. The agreement we reached was the first time the United States has received significant compensation for any trade losses due to EC expansion.

In other negotiations, the United States and the EC tentatively resolved the thorny dispute over citrus trade. Under the agreement which has now been approved by the EC Council, the EC agreed to approve access for U.S. oranges, lemons and minneolas. In the course of the negotiations, both countries agreed to improve access for a number of other products.

While we are delighted with these successes, we do continue to have serious differences with the European Community. We are particularly concerned about the new proposal for a consumer tax on vegetable oil. We can ill afford to give any ground on this issue. This is more than a threat to U.S. soybean exports, it looms over what had been a promising first few months of the new multilateral trade negotiations.

MULTILATERAL TRADE NEGOTIATIONS OBJECTIVES

We have great expectations in the new MTN. We pressed hard and effectively to get all the participants to agree that the negotiations will address three areas we believe are sabotaging free trade. Namely, subsidies that directly or indirectly impact on trade; import barriers; and food, plant and animal health regulations.

FARM BILL PROGRAMS EXPAND EXPORTS

On another front, working with the General Sales Manager's Office, FAS is aggressively using the tools provided by the 1985 Food Security Act's trade title to expand exports. This legislation authorizes a number of export programs—for example, the Export Enhancement Program and the Targeted Export Assistance Program—and they are already beginning to show positive results.

The General Sales Manager will have more to say on the individual programs in the course of his testimony.

FAS EFFORTS TO PROMOTE EXPORTS

In addition to these transitional measures to encourage exports, our cooperator program actively builds long-range demand, often in markets unfamiliar with particular U.S. commodities. This program is an excellent example of government-private sector cooperation. In fact, over the 30-year history of the program, cooperator contributions have exceeded U.S. Government outlays by a ratio of 2 to 1. We intend to continue our financial commitment to the cooperator program in fiscal year 1988 at the same level as this year.

To develop and implement international programs like the ones I have mentioned, we have a network of agricultural counselors, attachés and trade officers who represent and promote U.S. agricultural interests around the world. We now have 15 trade offices around the world. Most recently, offices were opened in Tokyo, Instanbul and Bagdad.

These agricultural experts work to help U.S. exporters make sales, to maximize trade access for U.S. products, to collect, analyze and report essential agricultural information, and to implement U.S. agricultural export programs.

FISCAL YEAR 1988 BUDGET REQUEST

Now I would like to highlight our budget request.

The fiscal year 1988 budget proposal for FAS is $85.6 million. This represents an increase of $3.4 million from the adjusted base for fiscal year 1987.

This increase consists of $1.8 million for pay costs and the government's contribution to the Federal Employees Retirement System and $1.6 million to partially fund unavoidable inflationary increases in overseas operating costs.

We are proposing to offset the balance of the increased costs through selected reductions in our overseas presence.

That concludes my statement, Mr. Chairman.

PREPARED STATEMENT

Senator Burdick. Thank you, Mr. Kay. Your complete statement will be inserted in the record.

[The statement follows:]

STATEMENT OF THOMAS O. KAY

Mr. Chairman, members of the Subcommittee. I appreciate the opportunity to meet with you to discuss the work of the Foreign Agricultural Service and to present our budget request for fiscal 1988.

Agriculture is one of the most important economic sectors affecting the welfare of the United States. The long-term success of the industry continues to be heavily dependent on our ability to export.

Roughly one-quarter of all that U.S. farmers produced in 1986 went to overseas destinations. While that was less than in some of the boom years of the late 1970s and early 1980s, exports remain crucial to agribusiness in general and our farmers in particular.

Other major agricultural producers are just as reliant on exports, and that will continue to make this the most competitive era that U.S. agriculture has ever encountered.

Under these circumstances, the work of FAS is becoming increasingly vital. Today, I would like to discuss briefly the outlook for our agricultural exports and the role that FAS is fulfilling to better the U.S. export position.

OUTLOOK

Despite the intense competition, our export position is better than it has been in several years, and there are a number of reasons for cautious optimism.

--Declines in the U.S. dollar are making U.S products less expensive for foreign buyers.

--This fiscal year, for the first time in five years, we expect to register increases in the volume of our agricultural exports.

--Economies in several Asian countries have been expanding, and this has been especially beneficial to our specialty crops and products.

--Interest rates are down, and that has helped a number of Third World nations handle their debts.

The last point is particularly important for establishing a lasting recovery for our agricultural exports. The Third World encompasses three-quarters of the world's population. When those nations are in good economic shape, they represent a growing demand for the world's major producers. There is no doubt that their recovery can contribute to the growth of U.S. agriculture, but that is part of a long-term scenario.

This Administration thinks that the best and quickest way to bring along the Third World, expand the world economy in general and nurture the growth of U.S. agriculture is to allow market forces to control supply and demand. The faster governments liberalize trade, the faster we are going to see world trade grow.

TRADE POLICY ACTIVITIES

. To meet the export challenge the Foreign Agricultural Service is active on a number of fronts. Among the most prominent efforts for the immediate future are those in the area of trade negotiations.

For the rest of the decade, U.S. agricultural export prospects will be greatly dependent on what is achieved during the Uruguay Round of the Multilateral Trade Negotiations, which was launched under GATT last September.

The Uruguay Ministerial Declaration, generated at the opening of the GATT talks in Punta del Este, was a landmark for agriculture. For the first time, an entire section was devoted to agriculture, setting out the scope of negotiations in broad terms and explicitly calling for all measures to be subject to negotiation.

Most of the world has yet to realize and adjust to the dramatic changes which have taken place in the world's supply situation. We still see many countries providing incentives to their farmers to step up production of commodities when the world already has more than ample stocks of these items.

The United States sees the Uruguay Round as the best hope of producing a global solution to the problems now besetting world agriculture, a solution that will benefit agricultural systems in all nations.

The three goals our negotiators have been charged with are:

--To freeze the present level of direct and indirect subsidies that directly or indirectly impact on trade and eventually phase them out;

--To halt the imposition of new import barriers and to phase out existing barriers; and,

--To harmonize food, plant and animal health regulations.

In addition, the United States is seeking improvement in general GATT dispute settlement procedures so that once trading nations have agreed on better rules, we can be assured these rules will be applied consistently and dependably. As it now stands, procedures are too easily blocked by the parties to a dispute when they believe the rules have not been interpreted to their advantage.

A streamlined GATT process will facilitate the pressure we can bring to bear through Section 301 cases which give the United States the right to retaliate against unfair trade practices. As part of this Administration's tougher attitude about trade, Section 301 is a valuable tool which we will use aggressively as situations warrant.

The Uruguay Round is not the only area where we have been negotiating for liberalized trade. We have been working with the EC to try to resolve major problems revolving around the accession of Spain and Portugal to the EC. Together, these two countries represent a $1-billion market for U.S. farmers.

Late in January, we reached a settlement on this matter--the first time the United States has received full compensation for the loss of a grain market resulting from enlargement of the EC. The concessions the United States will receive will be in the form of renewed corn and sorghum sales to Spain and Portugal, as well as additional EC tariff reductions on 26 other agricultural and industrial products.

In other talks, the United States and the EC tentatively resolved their 17-year-old dispute over citrus trade. Under the agreement, which still must be approved by the EC Council, the EC agreed to improve access for U.S. oranges, lemons and minneolas.

In the course of the negotiations, both countries agreed to improve access for a number of other products.

Closer to home, we have begun negotiations with Canada to pursue a comprehensive free trade agreement (FTA). As you know, Canada is an extremely important market. We are each others single largest trading partner with over-all, two-way trade valued at $120 billion--agricultural trade accounts for nearly $4 billion of the total.

Our negotiations for an FTA are aimed at eliminating both tariff and non-tariff trade barriers in order to promote more cross-border trade, better economic use of our resources.

This past year was the occasion for a number of other positive market access developments. Let me name just a few.

We have continued to press for improved market access for U.S. farm products--especially high-value and processed items in Japan, Korea and other Asian countries which enjoy a trade surplus with the United States. Japan agreed to our fumigation procedures for California cherries and walnuts. U.S.-Japan forest product negotiations held under the MOSS (market-oriented sector selective) format resulted in a number of measures to improve access, including a significant tariff cut to be instituted April 1. Negotiations to improve access for imported wines resulted in a 33-percent tariff cut for bottled wines, a 50-percent cut for wine coolers, and more equitable tax treatment. We are pursuing Japan's import quotas on 12 agricultural products, including peanuts, beans, and fruit juices, in the GATT. Later this year, we will commence discussions on Japan's beef and orange quotas, with a view to market liberalization.

In Taiwan, we reached agreement with the wine, beer and tobacco monopoly to open the Taiwanese market for U.S. exports for products under its control. Taiwan also agreed to improve access for a range of other agricultural products including a lifting of the import ban on pears and significant tariff reductions for such items as almonds, raisins, cherries, fruit juices and softwood plywood.

Mexico made a number of tariff concessions to the United States as part of the terms of its entry into GATT. Pakistan liberalized vegetable oil imports, and Korea agreed to liberalize its grapefruit juice market, to reduce tariff differentials between tropical and temperate hardwood, and to begin, for the first time, to open up its cigarette market.

FOOD SECURITY ACT AGENDA

In addition to negotiations, FAS also is responsible for implementing several portions of the 1985 Food Security Act's trade title. This title contains a number of provisions designed to meet subsidized competition, develop new markets and provide food assistance to needy countries.

The title reauthorized such long-standing export assistance programs as P.L. 480 (Food for Peace) and established new efforts such as the Targeted Export Assistance Program (TEA) and an intermediate credit guarantee program (GSM-103). It also provided continued support for several export assistance programs such as short-term export credit guarantees (GSM-102) and the Export Enhancement Program (EEP), which was initiated in May 1985.

The General Sales Manager will go into detail on a number of these areas because they come under his immediate purview. I would, however, like to say a few words about the Targeted Export Assistance Program and the Export Enhancement Program because they are graphic examples of activities which have had immediate effects on our agricultural exports.

Under the Targeted Export Assistance Program, USDA uses surplus stocks from the Commodity Credit Corporation to partially reimburse organizations for export promotion programs they undertake. The goal of the program is to help producers who are hurt by unfair trade policies of competing nations.

During fiscal 1986, we signed 42 contracts to provide $110 million in promotional assistance for a variety of products. The projects were wide ranging and imaginative. A TEA program promoting cotton in Western Europe and Asia aims at reaquainting consumers and and textile manufacturers with the advantages of using U.S. cotton. The availability of TEA assistance has enabled the mounting of large scale advertising campaigns and technical seminars which had not been possible in the past.

Another program involved the construction of a three-story model home in Japan to demonstrate the use of U.S. wood products. Not too long after the dedication of "Summit House," the Japanese Ministry of Construction decided to seek legislative approval for a change in building codes which would have a major positive effect on imports of U.S. wood products. Our solid wood product exports to Japan now exceed the $1-billion level--complete access to the Japanese wood market could increase that figure by 50 percent.

Under The TEA programs for horticultural products, emphasis was placed on initiating new or expanded promotional activities in Pacific Rim countries, primarily Japan. Products heavily promoted in this market during the last half of 1986 included fresh citrus, inshell walnuts, raisins, almonds, canned peaches, frozen potatoes, and table wine. With the assistance of this promotional push, exports of the promoted products to Japan during the six months increased in total by $65 million (46 percent) from the same period a year earlier. In the competitive European Community market, new promotional programs for walnuts, prunes, fresh grapefruit, and wine helped achieve a $17 million (37 percent) boost in exports of those products.

The TEA program is an excellent example of how government and the private sector can work together to build exports.

The Export Enhancement Program is another way in which we are offsetting the effects of unfair trading practices. Under EEP, bonuses of CCC-owned commodities are awarded to exporters to encourage trade with markets where the United States has been undercut by unfair competition.

Since EEP was begun in the summer of 1985, there have been 64 initiatives announced for 40 countries. More than 23 million metric tons of grain and products have been announced as available under EEP; other commodities have included eggs, frozen poultry, dairy cattle and vegetable oil. EEP initiatives accounted for about one-fourth of U.S. wheat sales in fiscal 1986. So far, over 11 million tons of wheat and flour have been sold. Other commodities moved included 2.8 million tons of barley and quantities of rice, frozen poultry, vegetable oil, dairy cattle, eggs, sorghum semolina, and flour, poultry feed and barley malt.

FAS will continue to operate the Targeted Export Assistance Program and the Export Enhancement Program in ways which will best advance our interests in areas where the competition has hurt U.S. commodity sales by subsidizing their own.

LONG-TERM MARKET DEVELOPMENT

In addition to short-term efforts like the TEA and EEP programs, FAS also has responsibility for long-term market development. Since 1954, this work has been carried out principally through nonprofit agricultural trade associations called "cooperators." During 1986, FAS and Cooperator groups conducted about 5,600 promotional activities in 130 countries world wide.

Cooperator groups contribute the major share of the operating expenses of this joint market development program. In fact, over the 30-year history of the program, cooperator contributions on the average have exceeded U.S. Government outlays by a ratio of 2 to 1.

Foreign promotion programs typically include trade servicing, training and education programs, technical seminars, demonstrations, international trade exhibits, consumer and trade advertising, merchandising and trade missions to and from the United States.

A few examples of some recent progress show why this program is so important:

--A "Buy American" feed grain initiative in Korea which has helped stem the decline in feed grain sales.

--U.S. Wheat Associates' noodle promotion in Sri Lanka resulted in increased wheat demand and imports.

--Pecan promotion in Europe doubled year-earlier pecan imports in France, West Germany and the United Kingdom.

--U.S. Dry Pea and Lentil trade servicing team's successful negotiations with the Algerian Government resulted in the first ever direct sales of U.S. dry peas and lentils totaling more than $10 million, and have set the stage for future direct sales to that market.

--The California Table Grape Commission's strategy of broadening their promotions and merchandising campaigns beyond the traditional Japanese outlets contributed to record exports of 3,331 metric tons. Evidence of the success of their strategy is reflected in increases in California grape sales of 400 percent in Kita-kyushu, 162 percent in Mayazaki, and 337 percent in Hiroshima.

--A multi-year promotional effort by the National Sunflower Association, which included trade servicing, technical assistance and Mexican trade missions to the United States, culminated in 1985 in a 300-percent increase in U.S. sunflowerseed exports to Mexico over the previous year. As of August 1986, Mexican imports of U.S. sunflowerseeds were already at 130,369 tons or 500 percent over export levels of FY 1985.

GLOBAL AGRICULTURAL NETWORK

To develop and implement international programs like the ones I have mentioned, we have a network of agricultural counselors, attaches and trade officers who represent and promote U.S. agricultural interests around the world. At the direction of Congress, we now have 15 trade offices around the world--most recently, offices were opened in Tokyo, Istanbul and Baghdad.

These agricultural experts work to help U.S. exporters make sales, to maximize trade access for U.S. products, to collect, analyze and report essential agricultural information and to implement U.S. agricultural export programs.

FAS commodity and marketing specialists in Washington analyze the data collected overseas to produce commodity forecasts and guidance on market potential. Over the last few years, FAS has focused a great deal of effort on what the competition is doing. We have stepped up world-wide monitoring of day-to-day changes in world market prices and the intricacies of different terms, conditions and competitive practices.

Together, FAS' overseas staff provide U.S. farmers and traders with timely information on world supply and demand for U.S. agricultural products and provide policymakers with information needed to make decisions regarding U.S. and international agricultural interests.

In addition, FAS staff here and abroad have provided increased support for trade negotiations and for the operation of the credit, sales and food aid programs administered by the Office of the General Sales Manager.

BUDGET REQUEST

FY 1987

Before discussing our budget request for fiscal year 1988, I would like to comment briefly on our fiscal year 1987 situation.

Since I last appeared before you, the sharp decline in the value of the dollar against the Japanese yen and major European currencies has driven our fixed overseas operating expenses substantially upward. To address this problem, we have submitted for your approval, a supplemental to offset these unavoidable cost increases.

FY 1988

The fiscal year 1988 budget proposal for FAS is $85.6 million. This represents an increase of $3.4 million from the adjusted base for fiscal year 1987.

This increase consists of $1.8 million for pay costs and the government's contribution to the Federal Employees Retirement System, and $1.6 million to partially fund unavoidable increases in overseas operating costs.

We are proposing to offset the balance of the increased costs through selected reductions in our overseas presence.

For fiscal year 1988, funding for the Foreign Market Development Cooperator Program will remain at the fiscal year 1987 level.

That concludes my statement, Mr. Chairman. I will be glad to respond to questions.

OFFICE OF THE GENERAL SALES MANAGER

STATEMENT OF MELVIN E. SIMS, GENERAL SALES MANAGER

ACCOMPANIED BY:

GEORGE J. POPE, ASSISTANT GENERAL SALES MANAGER

WILLIAM L. DAVIS, ASSISTANT ADMINISTRATOR, COMMODITY AND MARKETING PROGRAMS

OPENING REMARKS

Mr. AMSTUTZ. Mr. Chairman, now if I may, I will call on Mr. Melvin Sims, General Sales Manager.

Mr. SIMS. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to discuss the programs of the Office of the General Sales Manager, and to present our budget proposals for fiscal year 1988.

With your approval, my detailed, complete statement will be submitted for the record, while for now I will briefly highlight the steps we are taking to add more punch to our efforts to make U.S. agricultural exports more competitive in world markets.

The continuing imbalance in global supply and demand of farm commodities makes it imperative to continue finding ways to stimulate U.S. exports of agricultural products. This past year has been an important period of transition to a much broader and more aggressive approach in boosting the competitiveness of U.S. agricultural exports.

The Food Security Act of 1985 established a significant set of legislative authorities intended to reassert the competitive position of U.S. agriculture.

In my role as General Sales Manager, I made a dozen trips overseas during the past year as a representative of U.S. farmers abroad visiting 16 countries in the Middle East, Africa, Asia, Europe and South America. Last year, my office facilitated the movement of nearly one-fifth of total U.S. agricultural exports.

I will now briefly describe some of the major export assistance programs and how they have helped U.S. agricultural exports during a difficult year for world trade.

EXPORT ASSISTANCE PROGRAMS

Under the Export Enhancement Program we call EEP, approximately $700 million in export bonuses have been awarded to help make U.S. commodities more competitive in the world marketplace. Over 14 million tons of commodities have been sold, including over 11 million tons of wheat or the grain equivalent of the wheat flour. These sales represented close to 3 percent of the value of total U.S. agricultural exports in fiscal year 1986.

The short- and intermediate-term credit guarantee programs continue to be the largest of our export tools. In fiscal year 1986, exports valued at more than $2.5 billion were registered under the program.

The Public Law 480 Food for Peace Program has an excellent record of success in supporting the market development, economic and humanitarian objectives of the United States.

In fiscal year 1986, we shipped over 6 million tons of commodity exports under titles I and III. Also in fiscal year 1986, 2.3 million tons of title II commodities were approved for donation to 65 countries. A new activity we have implemented under authority of Public Law 480 is the Local Currency Initiative that supports economic growth via the private sector in recipient countries.

Another new program, food for progress, is being carried out using the authority of Public Law 480 or section 416. The program will provide commodities to needy countries—initially in Africa—to support mutually agreed upon agricultural reforms.

The Targeted Export Assistance [TEA] Program is another new program that counters the effects of unfair trade practices by foreign competitors.

During fiscal year 1986, we signed agreements totaling $110 million, with 43 organizations to promote agricultural commodities under the TEA Program. Interest among private firms and export associations has grown rapidly because this program has been highly successful.

FISCAL YEAR 1988 BUDGET REQUEST

Our budget proposals for fiscal year 1988 demonstrate a continuing emphasis on aggressive activities to facilitate U.S. agricultural exports and develop long-term markets for our commodities overseas.

For fiscal year 1988, we are proposing a program level of $3 billion for short-term credit guarantees—GSM–102—$2 billion below the fiscal year 1987 program level. This would reduce the annual mandated level from $5 billion to $3 billion, and bring the program more in line with actual use in both fiscal years 1985 and 1986. For intermediate export credit guarantees—GSM–103—we propose a program level of $500 million, the same level as in fiscal year 1987 and the level mandated by the Food Security Act.

For fiscal year 1988, we are requesting a program level of $1.387 billion for Public Law 480 programs, a decrease of $76 million from the current fiscal year 1987 estimate.

Although this represents a 5-percent reduction in funding, the 7.8 million tons of exports expected to be moved will be 30 percent higher than the average annual level of shipments during the early 1980's.

The budget proposes to continue the TEA Program in fiscal year 1988, but at a reduced level. We will be submitting proposed legislation to lower the program level mandated in the Food Security Act from $110 million to $80 million in fiscal year 1988. For fiscal years 1989 and 1990, the program level will increase to $295 million for each year.

For fiscal year 1988, we are requesting $7.3 million for the General Sales Manager's Office, an increase of $315,000 from the adjusted base for fiscal year 1987.

This concludes my statement, Mr. Chairman. I welcome the opportunity to answer your questions.

PREPARED STATEMENT

Senator BURDICK. Thank you. Your complete statement will be made part of the record.

[The statement follows:]

STATEMENT OF MELVIN E. SIMS

Mr. Chairman, members of the Subcomittee, I appreciate the opportunity to discuss the programs of the Office of the General Sales Manager and to present our budget proposals for fiscal year 1988.

Prospects of a continuing imbalance in global supply and demand of farm commodities, growing surpluses, and shrinking export demand make it imperative to continue finding ways to stimulate U.S. exports of agricultural products.

This past year has been an important period of transition to a much broader approach in boosting the competitiveness of U.S. agricultural exports. The Food Security Act of 1985 established a significant set of legislative authorities intended to reassert the competitive position of U.S. agriculture.

New export programs now operating include the Export Enhancement Program, the Targeted Export Assistance Program, the Intermediate Credit Guarantee Program, Food for Progress, programs for red meat sales, and expanded dairy product exports through Section 416 donations, direct Commodity Credit Corporation (CCC) sales, and the Dairy Export Incentive Program.

As a key representative for U.S. farmers abroad, the General Sales Manager is a traveling salesman with a territory that has no limits. Getting together face-to-face with clients has been extremely important in putting together sales in which buyer and seller are sometimes separated by half the globe. Last year my office facilitated the movement of nearly one-fifth of total U.S. agricultural exports.

In my role as General Sales Manager, I made a dozen trips overseas during the past year, visiting 16 countries in the Middle East, Africa, Asia, Europe, and South America to meet with foreign government officials, official buying agencies, private sector importers, and U.S. cooperator representatives.

During the same period, numerous delegations visited the United States to discuss our sales programs and, in many cases, purchased U.S. agricultural commodities.

I will briefly describe some of the major export assistance programs and how they have helped U.S. agricultural exports during a difficult year for world trade.

Export Enhancement Program

Under the Export Enhancement Program (EEP), agricultural commodities owned by the CCC are made available as a bonus to U.S. exporters to expand exports of U.S. agricultural products into targeted markets.

Since the fall of 1985 approximately $700 million in export bonuses have been awarded to help make U.S. commodities more competitive in the world marketplace, and to offset the adverse effects of unfair trade practices or subsidies.

Since the Export Enhancement Program was initiated in 1985, my office has approved for export 64 initiatives with 40 countries.

Over 14 million tons of commodities have been sold, including over 11 million tons of wheat and wheat flour (grain equivalent), nearly 3 million tons of barley, 64,000 tons of semolina, about 65,000 tons of barley malt, and some 39,000 tons of rice.

In addition, 82,000 tons of frozen poultry and 29,000 dairy cattle have been sold as well as 106,000 tons of sorghum, 25,000 tons of vegetable oil, 7,000 tons of poultry feed, and 28 million eggs.

These sales represented close to 3 percent of the value of total U.S. agricultural exports in fiscal 1986, including more than a fourth of the volume of U.S. wheat sales.

The Export Enhancement Program is an example of how commodity analysis and market development efforts must function together to effectively carry out the responsibilities of the General Sales Manager.

Credit Programs

The GSM-102 program has been in operation since 1980 and is designed to expand U.S. agricultural exports by guaranteeing repayment of short-term credit made to eligible countries that purchase U.S. farm products. This continues to be the largest of our export tools.

The program operates in cases where credit is necessary to increase or maintain U.S. exports to a foreign market and where private financial institutions would be unwilling to provide financing without CCC guarantees.

The GSM-102 program offers credit terms of up to three years and provides coverage for all agricultural commodities, including some fish products.

In fiscal 1986, we made available $4.2 billion of short-term guarantees for 26 countries for a variety of commodities. Exports valued at more than $2.5 billion were registered under the program. So far in fiscal 1987, we have announced $3.7 billion of short-term guarantees available for 27 countries.

The Food Security Act also authorized implementation of an Intermediate Credit Guarantee Program with 3- to 10-year terms, and requires that $500 million of these guarantees be made available each year through fiscal year 1988. For fiscal years 1989 and 1990 not more than $1.0 billion of these guarantees are to be made available. This program is designed to help developing nations make the transition from concessional financing to cash purchasers.

In developing this program we worked closely with the U.S. financial community and prospective clients to develop workable rules.

Intermediate credit programs valued at $377 million were announced in fiscal 1986 for both breeding stock and agricultural commodities. However, time limitations did not allow many sales and financing arrangements to be negotiated.

Substantially larger use of the programs is expected this fiscal year. In fact, through the middle of January, we had announced the availability of $227 million worth of intermediate guarantees to 18 countries.

Public Law 480--Food for Peace Program

The P.L. 480 Food for Peace program has an excellent record of success in supporting the market development, economic, humanitarian, and foreign policy objectives of the United States.

The General Sales Manager has primary programming and operational responsibility for the Title I concessional sales program, and Title III activities.

The Agency for International Development (AID) has primary programming responsibility for the Title II donations program, and operational activities are the joint responsibility of USDA and AID.

The Title I concessional sales program has been effective over the years in both economic development and the creation of commercial markets for U.S. farm products.

In fiscal 1986, we signed agreements under the P.L. 480, Title I/III program with 33 countries for a total commodity value of $872 million. Sales registered under these agreements were for over 6 million tons of commodity exports. Also in fiscal 1986, 2.3 million tons (grain equivalent) of P.L. 480, Title II commodities, valued at $441 million, were approved for donation to 65 countries.

A new activity we have implemented under authority of Public Law 480 is the Local Currency Initiative. This will support economic growth via the private sector in recipient countries.

To achieve this goal, sales of U.S. farm products for local currency have been reinstated. These local currencies, which are owned by the U.S. government, will be loaned to private financial intermediaries in Title I countries, who will then re-lend them to the local private sector.

Guidelines for this new program have been developed and the first agreement to include local currency was signed in November. Agreements, including $14 million in local currency financing, have been signed with Costa Rico, Jamaica, Sri Lanka, and Tunisia. U.S. embassies in several other countries have reported interest in the program.

Another new program, Food for Progress, is being carried out using the authority of P.L. 480 or Section 416(b). The program will provide commodities to needy countries--initially in Africa--to support mutually agreed upon agricultural reforms.

In fiscal 1986, we signed Food for Progress agreements with Madagascar and Guinea, which provided 60,000 tons of rice under the authority of Section 416(b) of the Agriculture Act of 1949. The review process for agreements to be signed this fiscal year is underway and the program is being expanded worldwide.

The Farm Bill includes several major amendments to Section 416, including its expansion to make available for donation all edible commodities held by the CCC.

In fiscal 1986 a total of 336,000 tons of grain and dairy products valued at $125 million were approved for donation overseas.

For fiscal 1987, the CCC has determined that 500,000 tons of oilseeds and grains and 150,000 tons of dairy products are available for donation to needy countries under this authority.

Also, donated commodities may be sold or bartered with the approval of the Secretary of Agriculture to finance distribution, handling, and processing costs or for other purposes consistent with providing food assistance to needy people. A minimum of 5 percent of all commodities donated to private voluntary agencies and cooperatives are to be sold each fiscal year.

Targeted Export Assistance (TEA) Program

The Targeted Export Assistance (TEA) Program is another new program which provides export assistance for U.S. agricultural commodities to counter the effects of unfair trade practices by foreign competitors. The legislation permits support in the form of either cash or commodities--the latter is the new feature.

During fiscal 1986, we signed agreements, totaling $110 million, with 43 organizations to promote agricultural commodities under the TEA program.

Interest among private firms and export associations has grown rapidly because this program has been highly successful.

The program's results have exceeded all expectations. For instance, exports of U.S. table wine through November 1986 to the targeted countries of Japan, Hong Kong, Singapore, and the United Kingdom rose about 70 percent. By contrast, shipments to other destinations increased 12 percent.

Canned peach and fruit cocktail exports to Japan more than doubled and those to Taiwan expanded more than one-third. Aggressive TEA campaigns in Spain, West Germany, and Japan saw walnut exports climb 20 percent--despite a poor crop and higher prices.

Meat and Dairy Export Programs

Several new export initiatives are tied to the implementation of the Dairy Termination Program. The Food Security Act required USDA to purchase at least 90,000 tons of red meat for export during the 18-month duration of the program. To date, 90,000 metric tons of beef have been sold to Brazil and 1,000 tons of pork to Argentina. To supply military commissaries in Europe, USDA has agreed to provide the Department of Defense with up to 20,000 tons of red meat between July 1986 and October 1987.

In addition, we sold 825 metric tons of high-quality U.S. beef to European importers under the annual quota available to the United States in the European Community.

We have also implemented a Dairy Export Incentive Program. It will make payments in CCC-owned dairy products on a bid basis to entities that sell U.S. dairy products for export. Export sales under the program must be additional and not displace commercial export sales.

The Mandated Dairy Sales Program requires that in each of fiscal years 1986-88 the CCC enter into export sales of not less that 150,000 metric tons of CCC-owned dairy products.

These CCC sales cannot disrupt domestic U.S. markets or world prices and patterns of commercial trade. In fiscal 1986, some 167,786 tons of nonfat dry milk and 3,000 tons of butter oil were sold. Thus far in fiscal 1987, the CCC has sold over 128,000 tons of nonfat dry milk and 1,000 tons of butter oil.

Budget Request for Fiscal Year 1988

Our budget proposals for fiscal 1988 demonstrate a continuing emphasis on activities which facilitate U.S. agricultural exports and develop long-term markets for our commodities overseas. Our request reflects a balance between these objectives and the need to achieve a reduction in the U.S. Government deficit.

CCC Export Credits

For fiscal 1988, we are proposing a program level of $3 billion for short-term credit guarantees (GSM-102), which is $2 billion below the fiscal 1987 program level. This budget proposal assumes enactment of an amendment to the Food Security Act of 1985, reducing the annual mandated level from $5 billion to $3 billion. This will bring the program more in line with actual use in both fiscal 1985 and 1986 when sales registrations totaled about $2.5 billion under the program.

For intermediate export credit guarantees (GSM-103), we are proposing a program level of $500 million, the same level as in fiscal 1987 and the level mandated by the Food Security Act.

Public Law 480 (Food for Peace) Program

For fiscal 1988, we are requesting a total program level of $1.387 billion for the P.L. 480 program, a decrease of $76 million from the current fiscal 1987 estimate.

Although this represents a 5-percent reduction in funding, the 7.8 million tons of exports expected to be moved will be 30 percent higher than the average annual level of shipments during the early 1980's.

Our request for the Title I/III sales program is $852 million, which will provide long-term concessional financing for approximately six million tons of agricultural commodity exports.

We are requesting a program level of $535 million for the Title II program, which will provide at least 1.9 million tons (on a grain equivalent basis) of food donations, the annual statutory minimum tonnage for the the program. While this is somewhat lower than in fiscal 1987, the level of U.S. foreign food assistance will be augmented by donations from CCC-owned stocks through the Section 416 Program.

Targeted Export Assistance (TEA) Program

The budget proposes to continue the TEA program in fiscal 1988, but at a reduced level. We will be submitting proposed legislation to lower the program level mandated in the Food Security Act from $110 million to $80 million in fiscal 1988. For fiscal years 1989 and 1990 the program level would increase to $295 billion for each year.

The General Sales Manager's Office

FY 1987

I would like to comment briefly on the budget situation for fiscal year 1987 before discussing the fiscal year 1988 request.

Earlier in my testimony, I outlined the new and expanded programs added to the Office of the General Sales Manager, by Food Security Act of 1985. These significant additional reponsibilities were not accompanied by comparable increases in our administrative budget.

While we have done our best to meet these new challenges, it has become clear that our current funding level is not sufficient to execute successfully both the traditional program responsibilities of the General Sales Manager and the new programs mandated by the Food Security Act.

To remedy this situation, we have submitted for your approval a supplemental budget request of $705,000 to provide the additional support necessary to carry out the full responsibilities of the office during the remainder of this year.

FY 1988

For fiscal year 1988, we are requesting $7.3 million for the General Sales Manager's office. This represents an increase of $315,000 from the adjusted base for fiscal year 1987. These additional funds are necessary to cover the increased pay costs and the government's contribution to the Federal Employees Retirement System.

That concludes my statement, Mr. Chairman. I welcome the opportunity to answer your questions.

OFFICE OF INTERNATIONAL COOPERATION AND DEVELOPMENT

STATEMENT OF JOAN S. WALLACE, ADMINISTRATOR

ACCOMPANIED BY:

JAMES L. WALKER, ASSISTANT ADMINISTRATOR FOR INTERNATIONAL RESEARCH AND DEVELOPMENT

AVRAM GUROFF, DEPUTY ASSISTANT ADMINISTRATOR FOR INTERNATIONAL AFFAIRS AND PLANNING

TOMMYE COOPER, ACTING ASSISTANT ADMINISTRATOR FOR ADMINISTRATION

OPENING REMARKS

Mr. AMSTUTZ. Mr. Chairman, now if I may, I will call on Dr. Joan Wallace, the Administrator of the Office of International Cooperation and Development.

Dr. WALLACE. Mr. Chairman and members of the subcommittee, thank you for this opportunity to review the programs and proposed budget for the Office of International Cooperation and Development. I will submit my statement for the record and proceed with a short version.

Our Office of International Cooperation and Development manages a broad range of agricultural programs around the world. We work closely with others in the U.S. agricultural community—universities, private sector businesses, USDA, and other government agencies. The goal is to help reduce hunger in lower income countries while at the same time fostering economic development and mutually beneficial relationships.

We also want to create the opportunity to help our farmers here in the United States.

OICD CURRENT ACTIVITIES

Let me describe some of these activities. Disease and insect pests with the potential to create massive economic destruction to U.S. crop, agriculture and livestock industries are primary subjects for our research activities overseas. For example, we have taken the lead on the bont tick and the heartwater disease that it fosters in the Caribbean. The National Cattlemen's Association and the Animal Health Association are most interested in this endeavor. Other research overseas is exploring the use of plant hormones to extend the shelf life of leafy vegetables. This would eliminate the need for sulfites, which have caused allergic reactions and even deaths in the United States.

RESEARCH PROJECTS

Another project is exploring the use of ultra-high temperatures to eliminate problems associated with the reconstitution of U.S. dry milk overseas, thus potentially expanding the market for our dry milk. Negotiations are currently underway on a project to develop processes for increasing the thermal stability of soybean cooking oil, again trying to increase our sales.

This international research program managed by OICD is very cost effective. Research costs overseas are approximately 20 percent of what expenses would be for similar work in the United States.

Another benefit is that international research permits work on exotic pests and diseases that could not be done in this country because of the dangers of inadvertently introducing the problems into our own environment.

SCIENTIFIC AND TECHNICAL EXCHANGE

Our scientific and technical cooperation programs enable us to share data, collect exotic germplasm and biological materials, and learn how to better deal with disease and insect pests.

To illustrate, a species of Africanized honey bees are said to be moving toward the United States from Central America at a rate of about 250 miles per year. There have been isolated sightings in a couple of states. These bees of African descent are a threat to the $20 billion U.S. agricultural industry as they may interfere with the pollination of our crops, and their unpredictability will affect the honey industry.

Through our programs, U.S. scientists have gone to Kenya to identify colonies of gentle African bees which can be bred with the Africanized bees in hopes of reducing their aggressive behavior. They are also working with Mexico, through APHIS, to set up a barrier in Mexico to slow or prevent their northward movement.

Aside from the unpredictability of the bees themselves, they carry parasitic mites. These mites are already in this country, but we do not wish to have more of them.

I just returned from a conference at Ohio State University on the Africanized bee, and the tracheal and varora mites. That conference had experts from 22 countries and 14 universities and was cosponsored by the university and OICD.

VERNONIA GALAMENSIS

Another project is collecting Vernonia galamensis. This plant comes from Zimbabwe, Africa, and has created much excitement among U.S. researchers because it produces an industrial oil which is similiar to sperm whale oil, and is essential to U.S. industries because of its effectiveness in lubricating machinery with extremely close tolerances. The crop would not compete with any crop currently produced here, and it holds great potential benefit for farmers in arid regions.

INTERNATIONAL ORGANIZATION ACTIVITIES

As coordinators of U.S. participation in activities of international food and agricultural organizations, we ensure that U.S. agriculture's views are reflected at the policy level.

OICD also represents the Department's position on proposed loans from international financial institutions in order to protect U.S. farmers' interests.

AGRIBUSINESS INFORMATION CENTER

In support of the private sector, we established an agribusiness information center in 1986. The center disseminates information on U.S. grades and standards, U.S. import regulations, market development opportunities, and trade statistics to agribusiness firms interested in trade linkages with other countries.

TECHNICAL ASSISTANCE

Some of our programs are not funded by USDA appropriations. Our largest program, technical assistance, sends specialists overseas to support projects designed to strengthen economies, increase income, build infrastructure and human resources, and, in fact, build trading partners in developing nations. These activities are in cooperation with the U.S. Agency for International Development and are completely reimbursable.

One example of our work with U.S.A.I.D. is controlling the outbreak of locusts and grasshoppers that threatened to destroy African crops.

INTERNATIONAL TRAINING

Most international training activities we manage are done on a reimbursable basis, with funding from AID, the Food and Agriculture Organization and other sponsors.

The one training program that uses appropriated funds is the Middle Income Country Training Program initiated by Congress 4 years ago. Last year, we had 215 trainees from eight middle income countries selected for this program. Each trainee's sponsoring organization paid the international airfare and the U.S. commodity trade groups, such as the Feeds Grain Council, provided some of the training at little or no cost while students were here. This cost sharing approach greatly expanded the impact of the appropriated funds.

BUDGET REQUEST

With this quick overview of our programs, let me turn to our fiscal year 1988 budget request.

We are requesting slightly over $3.8 million for our appropriated programs, a net reduction of $3.7 million from the level available in fiscal year 1987. The largest components of this reduction are the proposals to phase out the Foreign Currency Research Program of $2.5 million and the Middle Income Country Training Program of $1.5 million. Our request does provide $511,000 for increased costs associated with salary adjustments and the Federal Employees Retirement System.

In terms of programs, the $3.8 million would continue some of the important scientific cooperation activities that have brought much basic information on animal and plant protection, new germplasm, and other benefits to the United States.

Among exchanges projected for fiscal year 1988 is the firsthand study of the French research with the Chinese Meishan hogs. This will provide us essential knowledge that could lead to increased U.S. swine litter sizes, answering the question: Why are Meishan hogs so prolific?

Our research includes the development of technology to economically remove lactose from milk; this research is needed because a large percentage of the world population cannot digest lactose. Other programs include continued study in Argentina and Taiwan on citrus canker, a problem of great concern to the citrus industry; and economic/marketing studies concerned with the use of hardwoods for new markets for U.S. wood and wood products.

While our request for appropriated money is small, it plays a crucial role in our total program. The appropriation represents entire funding for some of the programs which bring valuable benefits to America.

Ultimately, it is the American farmer who benefits as we help bring to our shores new crop varieties, prevent or control potentially devastating animal and plant diseases and pests, and other agricultural technologies that can protect our farmers and give them new sources of income, reduce costs and make them more competitive in the marketplace.

Mr. Chairman, this ends my statement. I will be happy to respond to questions.

PREPARED STATEMENT

Senator BURDICK. Thank you. We have your complete statement and it will be inserted in the record.

[The statement follows:]

STATEMENT OF JOAN S. WALLACE

Mr. Chairman, members of the Subcommittee. Thank you for this opportunity to review the programs and proposed budget for the Office of International Cooperation and Development, or OICD, as we are known in the U.S. Department of Agriculture.

OICD manages a broad range of agricultural programs around the world, working closely with others in the U.S. agricultural community -- universities, private sector businesses, USDA and other government agencies. These efforts include technical assistance, training, international research, scientific and technical cooperation, U.S. policy representation to international food and agricultural organizations, and strengthening the involvement of the private sector internationally. The goal is to help reduce hunger in lower income countries while at the same time fostering economic development and mutually beneficial relationships.

OVERVIEW OF FY 1986 ACTIVITIES

An overview of our activities in fiscal year 1986 will illustrate OICD's efforts. We:

- Sent 760 specialists overseas to provide assistance with specific development problems in 87 countries;
- Managed training for nearly 2500 agriculturalists from 110 countries, both in the United States and overseas;
- Sponsored 678 international research projects with 22 countries to help farmers, both at home and abroad, reduce losses caused by crop and livestock diseases and insect pests;
- Conducted 148 scientific and technical exchanges with 28 nations to gather and share information useful to the agricultural sector;
- Promoted private sector development in the Caribbean and Central American region; and
- Managed U.S. participation in the international food and agriculture organizations.

ILLUSTRATIVE EXAMPLES OF PROGRAMS

Let me describe some of these activities in a bit more detail.

International Research

Diseases and insect pests with the potential to create massive economic destruction to U.S. crop and livestock industries are primary subjects for our research activities overseas. We have taken the lead on the Bont Tick and the heartwater disease problems that exist in the Caribbean, for example. The National Cattlemen's Association and the American Animal Health Association are very interested in these because of their potential threat to U.S. producers. A feasibility study has now been completed for a control program, with input coordinated from six U.S. and international agencies as well as the Island governments themselves.

We also use foreign currencies owned by the U.S. Government for research on a number of subjects of mutual interest to the United States and participating nations. One example is the use of plant hormones to extend shelf life of leafy vegetables; this would eliminate the need for sulfites, which have caused allergic reactions and even deaths in the United States recently.

Another project is exploring the use of ultra-high temperatures to eliminate problems associated with reconstituting U.S. dry milk overseas, thus potentially expanding the market for our dry milk. Negotiations are currently underway on a project to develop processes for increasing the thermal stability of soybean cooking oil, which we anticipate will significantly increase U.S. sales.

There are also international research programs that do not use USDA funds. For example, interest from a $110 million research and development fund established by the United States and Israel has provided funding for over 100 research projects of potential benefit to both nations. Several technological breakthroughs from this research are now in commercial use in the United States: state-of-the-art drip irrigation systems and a machine to separate soil clods from newly-harvested potatoes, for example.

The international research program managed by OICD is very cost effective; research costs overseas are only about 20 percent of what expenses would be for similar work in the United States. Another special benefit is that international research permits work on exotic pests and diseases that could not be done here because of the dangers of inadvertently introducing the problems into our own environment. Knowledge gained through such research can help us avoid or control the spread of new pests and pathogens.

Scientific and Technical Cooperation

Scientific and technical cooperation with other countries enables us to share data, collect exotic germplasm and biological materials, and learn how to better deal with plant and animal diseases and insect pests.

To illustrate, Africanized honey bees are now moving toward the United States from Central America at an estimated rate of 250 miles per year, causing great concern among scientists and producers here. There have even been isolated sightings in a couple of states. These bees pose a threat to the $20 billion U.S. agricultural industry as they interfere with the pollination of our crops by domesticated bees. At the same time, their aggressive nature creates a public safety threat for our people. Through OICD programs, U.S. scientists have gone to Kenya to identify colonies of gentle bees which can be bred with the Africanized bees to reduce their aggressive behavior. They are also working with bee specialists from other nations, especially Mexico and Canada, to develop eradication and quarantine measures. We are hopeful that, through these efforts, a serious Africanized bee problem here can be averted.

Another project is collecting *Vernonia galamensis* germplasm in Zimbabwe and Kenya. This plant, which produces an industrial oil, would not be in competition with any crop currently produced in the United States. It holds great potential benefit for farmers in the Southwest since it can be produced under arid conditions.

International Organization Affairs

As managers of U.S. participation in activities of international food and agricultural organizations, we ensure that U.S. views are reflected at the policy level when issues related to developing nations are being considered. Regular participation in ministerial-level meetings like the World Food Council is one example.

International financial institutions have increased their lending to the agricultural sector to help countries earn foreign exchange. This lending is often tied to macroeconomic policy reforms. Occasionally, a loan will support the export of a commodity which competes with U.S. agricultural producers. The Working Group on Multilateral Aid, an interagency body which reviews proposed lending, has been sensitive to economic and policy issues raised by USDA in connection with these loans. OICD represents the Department in the Working Group, gathering input from other USDA agencies to develop the Department's position on proposed loans in order to protect U.S. farmers' interests. OICD has established a Departmental committee to strengthen its process for analyzing lending.

We also play a major role in certain special projects. For example, OICD has coordinated U.S. involvement in an international agricultural study being done by the Organization for Economic Cooperation and Development (or OECD, as it is known generally). This study will demonstrate how domestic agricultural policies of the 24 OECD member countries produce distortive effects on international trade.

The elimination of trade barriers and the enhancement of trade opportunities are anticipated outcomes of this study. A summary of major findings will be presented to President Reagan and other Heads of State at the Venice Economic Summit later this year.

Private Sector Relations

In support of the Administration's emphasis on working with the private sector, we established an Agribusiness Information Center in fiscal year 1986. The Center disseminates information on U.S. grades and standards, U.S. import regulations, market development opportunities, and trade statistics. This is used by agribusiness firms interested in investment opportunities, joint ventures or trade linkages with other nations.

Technical Assistance

Some of our programs are not funded by appropriations, as you are aware. Our largest program, technical assistance, sends specialists overseas to support projects designed to strengthen economies, increase income, and build infrastructure and human resources in African and other developing nations. These activities are carried out in cooperation with the U.S. Agency for International Development (AID), and are completely reimbursable; no USDA appropriation is required. An example of a recent technical assistance program is OICD's work with AID to control the outbreak of locusts and grasshoppers that threatened to destroy African crops. USDA sent uniquely skilled technicians to Africa to assist in an aggressive spraying program. We are continuing to work with AID to plan for and implement a program to better monitor and respond to such outbreaks.

International Training

With the exception of the Middle Income Country Training Program, international training activities managed by us are also done on a reimbursable basis, with funding from AID, the Food and Agriculture Organization of the United Nations, World Bank, and the governments of other countries. Training programs range from academic degree work (almost entirely Master and Ph.D. levels) through short-term on-the-job or observation programs. USDA also manages some 50 technical short courses in collaboration with American universities and the private sector.

OICD currently has some 741 foreign students studying at universities throughout the United States and 278 foreign agriculturalists in short-term technical programs. Each academic student brings about $20,000 annually to the local U.S. community in the form of tuition, living allowances, and other related expenses.

The one training program that uses appropriated funds is the Middle Income Country Training Program initiated by the Congress 4 years ago. That program has been funded at approximately $1.5 million each year and is implemented in consultation with the Congress and the U.S. agricultural commodity trade groups. Last year, 215 trainees from 8 middle income nations were selected for this program. Each trainee's sponsoring organization paid the international air fare, and U.S. commodity trade groups provided some of the training at little or no cost while the students were here. This cost sharing approach greatly expanded the impact of the appropriated funds.

Many of these trainees are in key decisionmaking roles in both the public and private sectors in their countries, so there are direct benefits to the United States as a result of the program. For example, a Venezuelan participant in the 1985 program returned here this year at his own expense to purchase some 500 dairy cows on behalf of Venezuelan farmers.

THE PROPOSED BUDGET FOR FISCAL YEAR 1988

Having presented this quick overview of our programs, let me turn to our fiscal year 1988 budget request. We are requesting slightly over $3.8 million for our appropriated programs, a net reduction of approximately $3.7 million from the level available in fiscal year 1987. The largest components of this reduction are proposals to phase out both the Foreign Currency Research Program and the Middle Income Country Training Program. Our fiscal year 1988 request does provide $511,000 for increased costs associated with salary adjustments and the Federal Employees Retirement System.

In terms of programs, the $3.8 million being requested would continue the important scientific and technical cooperation activities that have brought much basic information on animal and plant protection and production, new germplasm, and other benefits to the United States. Among exchanges projected for FY 1988 are continuing research on the Africanized bee problem and development of the new, non-competitive crop which produces industrial oil, which I have already mentioned.

Exchanges with German scientists on acid rain and other atmospheric pollution problems will provide valuable information and guidance to our National Acid Precipitation Assessment Program. Firsthand study of French research with Chinese Meishan hogs will provide us essential knowledge that could lead to increased U.S. swine litter sizes. In cooperation with the National Agricultural Chemicals Association and USDA's Agricultural Research Service, we are also planning an international symposium in 1988 to address concerns about water pollution caused by agricultural chemicals.

This brief listing obviously just touches on the many exchange activities planned. However, I hope it will signal the many benefits to be gained from this effort.

Our fiscal year 1988 request likewise recognizes the crucial role OICD plays in ensuring that U.S. interests are well represented in the international food and agriculture organizations.

The budget request also provides for continuation of our valuable research programs overseas, although at reduced levels. Among proposals for research to be done in collaboration with foreign institutions during FY 1988 are:

- * Development of technology to economically remove lactose from milk. A large percentage of the world's population cannot digest lactose properly.
- * Continued study in Argentina and Taiwan on the epidemiology, control, and strain virulence of citrus canker, a problem of great concern to the U.S. citrus industry.
- * Economic/marketing studies concerned with use of hardwoods in the Far East, to lay the groundwork for new markets for U.S. wood and wood products.

In the development planning and analysis area, our fiscal year 1988 request proposes to continue our activities in conjunction with the International Science and Education Council (ISEC) and the Agribusiness Information Center. As I have not mentioned ISEC previously, let me explain that it is a coordinating and planning body composed of representatives from USDA and the university community. It provides guidance to USDA's international research, training, and technical assistance programs and coordinates involvement in these activities by the 300+ U.S. public and private colleges and universities, including the Historically Black Colleges and Universities. Because of the need to meet the deficit reduction targets established by the Balanced Budget and Emergency Deficit Control Act of 1985, a reduction of $198,000 in these development planning and analysis activities is proposed.

Our budget request contains no funding for two of our programs--Middle Income Country Training and the Special Foreign Currency Research Program; both are proposed to be phased out.

The Middle Income Country Training activity was initiated by Congress 4 years ago. While no further funding is proposed, training activities initiated with prior year funding will continue until completion.

Funding for the Special Foreign Currency Research Program has also not been requested. In fiscal year 1987, $2.5 million is available for this activity.

As noted earlier, many of our activities are actually paid for by other U.S. government agencies such as AID, international organizations such as the World Bank, or other country governments. While our request for appropriated money is small, it nonetheless plays a crucial role in our total program. The appropriation represents entire funding for some programs which bring valuable benefits to America.

Then, too, the appropriated funds are traditionally highly leveraged. They are multiplied by resources from U.S. and foreign research agencies, universities here and abroad, and the private sector. As an illustration, participating countries, universities, and USDA cooperators contribute roughly three dollars for every dollar spent by OICD for scientific and technical cooperation activities.

Appropriated funds indeed play a significant role in permitting a broad spectrum of international activities managed by OICD. Ultimately, it is the American farmer who benefits as we help bring to our shores new crop varieties; ways to prevent or control potentially devastating animal and plant diseases and pests; and other agricultural technologies that can protect our farmers and give them new sources of income, reduce their production costs, and make them more competitive in the marketplace.

Mr. Chairman, this is the end of my statement. I would be happy to respond to any questions.

INCREASING U.S. EXPORTS

Mr. AMSTUTZ. Mr. Chairman, that is the end of our statements. We will be happy to answer questions from the committee.

Senator BURDICK. These can be directed to anyone who cares to answer them.

Between 1974 and 1985, the U.S. agricultural trade balance represented an annual contribution of $10 to $25 billion. In fiscal year 1986, this contribution to the overall U.S. trade balance fell to $5.4 billion, and according to USDA estimates, it is expected to reach only $6 billion in fiscal year 1987. How can the United States increase the volume and value of its commodities for export? In what parts of the world may we expect to gain entry through expanded export markets in the next fiscal year?

Mr. AMSTUTZ. You asked a very large question, Mr. Chairman, and at the risk of oversimplifying the response, let me hit on two major factors as we see it.

IMPORTANCE OF EXPANDING WORLD MARKET

First, we think that it is extremely important to expand the size of the world market. A major problem that American agriculture has these years is that the global market is really not growing, not growing nearly as rapidly as it could if there was more ability to pay, more buying power, in Third World countries. Some 80 percent of the world's population lives in Third World countries. In virtually every instance in Third World countries there is plenty of potential for increased per capita consumption of food and fiber products. But there is a paucity of buying power.

The buying power really has to be generated in a real way as opposed to a credit way. In the last 20 years, there has been a significant change in the manner in which third world countries are willing to operate. Twenty years ago they were willing to go deeper into debt to finance purchases. This is really not the case any more. They are willing to borrow for subsistence levels of consumption. But beyond that, they don't want to dig themselves any deeper into a debt hole than American farmers or American businessmen do. So they want to generate the ability to pay. The ability to pay gets us quickly into an ability to generate foreign exchange.

It is timely that the subject is discussed because the ability of other countries to generate foreign exchange from which they can service their debt, from which they can finance development in their country, and from which they can pay for imports is directly related to the manner of trade legislation that is currently being considered by the Congress.

Our strong desire to allow markets to grow for American agriculture worldwide is the principal reason why the administration is so opposed to any elements of trade legislation that would be protectionistic. That is one point. That in order to expand exports, we need to do what we can to see that world markets expand.

IMPORTANCE OF FAIR TRADE

Then the other element I would suggest, Mr. Chairman, is that we need a fair level playing field around the world, and this is the focus of our attention on the new trade round, the Uruguay Trade Round, that got launched some 6 months ago in Punta del Este in Uruguay and is underway now. For the first time in any trade round, agriculture is a major component of this negotiation.

This administration is absolutely committed to a meaningful, comprehensive negotiation. The bottom line end objective is to create this level playing field, this fair trade climate anound the world. We have no illusions about the difficulty of doing that, but we think it is enormously important to achieve it. And as I say, Mr. Chairman, we are committed to it.

Progress in each of those areas would really do an enormous amount in providing the positive answer to the question you raised.

AGRICULTURAL GROWTH IN INDIA AND CHINA

Senator BURDICK. There is another complication too I mentioned 20 years ago. I was in India 20 years ago. Indian production of grains has gained by leaps and bounds since that time. Better techniques, better everything. They are not quite as dependent upon us or the world as they were before.

Mr. AMSTUTZ. That is right.

Senator BURDICK. Is that true of many countries?

Mr. AMSTUTZ. Oh, yes. And I understand that in certain quarters that is a concern. It is true of India, and it is true of China. I think those two countries, which incidentally have the largest populations of any countries in the world, represent the largest demand potential. Those two countries account for nearly one-half the world's population—1.7 billion people out of about 4 billion people in the world.

No question, each of those countries has made great strides in what is clearly their quest for self-sufficiency. In all of our meetings with them we suggest to them very strongly that the term that is important is not self-sufficiency, rather it is self-reliance. And we surely understand the economic soundness of countries seeking self-reliance, economic self-reliance. If countries are self-reliant, they need not fear the self-sufficiency question because the ability-to-pay problem for imports is taken care of.

Beyond that, the demand potential for food and fiber in countries like China and India is so dramatic, Mr. Chairman, that I believe American agriculture gains more by economic advancement in those countries than by any other economic occurrence.

There can be those periods of time when their own indigenous production sort of leapfrogs, on a short-term basis, their demand for product. But I would suggest that that is a short-term phenomenon. And the challenge those countries have and we have, as the years pass and as their economies grow, is to provide product to an expanded per capita demand from richer consumers. And we think economic recovery will continue in China and in India, and that those markets can be very good for American agriculture.

Senator BURDICK. Thank you.

The Senator from Iowa.

Senator GRASSLEY. I will direct my question to you, Mr. Secretary Amstutz. Considering the Export Enhancement Program, I believe, not only from my own part but for the Congress as a whole, we should look upon it as a temporary measure and, hopefully, something that would show signs that we meant business vis-a-vis our competitors overseas to bring them to the table to negotiate a way for their subsidies and help us get there.

USING MARKETING LOAN PROGRAM TO SPEED NEGOTIATIONS

Considering the fact that we haven't made much progress at getting them to negotiate or weigh their barriers, and also considering the fact that Clayton Yeutter has recently said that he thought a marketing loan program would get the EEC to the bargaining table 6 months earlier than they might otherwise be there.

Wouldn't it be better for us as a department and as an administration, particularly since we are the same political party to be supporting a marketing loan program instead of export enhancement, since it is not operating as effectively to get people to the negotiating table as we had hoped?

Mr. AMSTUTZ. Senator Grassley, I have to confess I was not aware of the comment from Ambassador Yeutter that you mentioned until I heard it from you.

PROGRESS IN TRADE NEGOTIATIONS

I would suggest that the record shows that we are making good progress in getting people to the negotiating table. We got the Europeans to agree to the declaration of Punta del Este on a new round of multilateral trade negotiations and work is now beginning in the new trade round. I surely appreciate that one of the problems with the trade round is that we are far less patient for speedy resolution than the Europeans, and that is one of the challenges we face. But I think the fact is that the record shows that we are making some progress, and I think that is one point.

EXPORT ENHANCEMENT PROGRAM

I think another point is that the export enhancement program has been a factor in bringing the European Community to the bargaining table. I think most, if not all, who are familiar with our Export Enhancement Program would agree with that. The program has been criticized for various reasons, but I would think virtually everyone would concur in the point that it has served a useful purpose in bringing people to the negotiating table.

Another consideration, which is unfortunately necessary in this day and age, Senator, is the outlay problem. The realities of Gramm-Rudman-Hollings and the limitations on outlays which are necessary in order to achieve the deficit reduction targets are enormously important—especially when one considers the possibility of marketing loan approaches, because those approaches can cause a dramatic increase in outlays.

I am sure, Senator, that we are of a single mind on the importance of reducing the budget deficit. The deficit is really, in my judgment, a bigger problem for agriculture than any other industry in our country. That is the principal reason why real interest rates are still higher than we would like them to be in the country.

Senator GRASSLEY. But, you see, we in the Congress who feel that you as an individual never did like the export enhancement program, don't know whether a budget item is a fiscal matter with you or a philosophical basis for your expressing a philosophical point of view. I just raise that for your consideration. You don't have to respond.

Mr. AMSTUTZ. Well, I am happy to respond, Senator.

Senator GRASSLEY. I guess I want to challenge you in your thinking. I don't want to let you think that you are pulling the wool over our eyes up here on the Hill.

Mr. AMSTUTZ. I am not trying to pull the wool over anyone's eyes, Senator.

Senator GRASSLEY. Well, I just want you to be cautious so you aren't.

Mr. AMSTUTZ. I make that statement because I believe what I have said about budget deficits.

Senator GRASSLEY. All right.

Mr. AMSTUTZ. And, Senator, I don't know whether anyone really knows my true feelings about some of these programs. Maybe some day I will write a book. But one thing that I believe, Senator, heart and soul, is that I do understand my job and my responsibilities. And a part of my responsibilities and part of my job are to do my best to carry out programs, especially those that are mandated by law, by the Congress.

Senator GRASSLEY. Can I go on to another point? Because I don't think I can be accused of any sin of being not happy with the slow movement at the bargaining table, even though there is considerable progress there. So I don't want to disagree, that probably there has been some progress, but I just don't know whether we would have the progress if we had a marketing loan program.

IMPACT OF CARGO PREFERENCE ON EXPORTS

Could I go on to one other point, and this is more of a statistical thing than a philosophical discussion? And I don't know whether you, Mr. Secretary, or somebody else could answer, but I am interested in cargo preference and the fact that it costs us $155 million. If we did not have cargo preference, how much more Public Law 480 products could we be shipping overseas for the same amount of money?

Mr. AMSTUTZ. Well, the price of corn these days f.o.b. is probably around $80 a ton. And so $80 a ton divided into $150 million, whatever that is, is how much additional product that could be exported.

Senator GRASSLEY. It is a significant amount.

Mr. AMSTUTZ. It is a very significant amount, Senator, no question. In a sense, it is an indirect tax, I think.

Senator GRASSLEY. Mr. Chairman, I have no further questions.

Senator BURDICK. Senator Cochran.

Senator COCHRAN. Thank you very much, Mr. Chairman.

Let me add my word of welcome to all the members of this panel and my thanks for your cooperation with our subcommittee. We appreciate having your statements and the comments that you have made in support of the budget request that has been submitted to the Congress.

ADEQUACY OF FAS RESOURCES

I worry about the impact of the funding request for the Foreign Agricultural Service. In the staffing area, I notice there have been added responsibilities, such as the Export Enhancement Program, the Targeted Export Assistance Program, and a mandate to establish trade offices. There has been no relief from traditional responsibilities, but additional staff has not been provided to help in dealing with the increased work requirements or responsibilities. As a matter of fact, there has been a gradual decline in staff resources over the past 10 years.

I wonder what the outlook is for handling these responsibilities without an additional appropriation to provide the people to do the work. Is there reason for concern or am I just imagining that this is a problem?

Mr. KAY. Senator, I guess it is my turn to respond.

FISCAL YEAR 1987 SUPPLEMENTAL REQUEST

As you pointed out, over the last 10 years our staff at the FAS has declined from around 900 down to 790 today. In the budget request which we sent to the Hill for 1988, we did include a fiscal year 1987 supplemental request for $705,000 to employ some additional people, enough to raise our personnel ceiling to 800. That supplemental, I believe, has been considered by the House and has been reported out of committee. It is true that the workload at FAS has increased, particularly with the passage of the 1985 farm bill. We received some 12 new programs which we are to administer. And should the committee in its wisdom see fit to approve the supplemental, it would be greatly appreciated, I am sure, by the troops at FAS.

WORKLOAD IMPACT ON MARKET DEVELOPMENT PROGRAMS

Senator COCHRAN. With fewer people and more responsibilities, what does this do to the cooperator program and how does that fit into your list of priorities? Has the cooperator program suffered as a result of these reductions over the past few years? And if so, to what extent?

Mr. KAY. Well, Senator, moneywise, the cooperator program has been fairly stable over the last few years. I am sure, like FAS, our cooperators have experienced difficulty as a result of the reduced value of the dollar overseas. Insofar as our attention to the cooperator program, I must say in all fairness to the people at FAS who administer that program and now the TEA Program, that they have found themselves suddenly administrating a program that instead of $30 million a year, is now around $140 million, when you include the $110 million for the TEA Program.

It is in a pressurized situation like that, perhaps, when oversight might not be sufficient, or less attention given than should have had the resources been more adequate.

EXTENDING EXPORT PROGRAMS TO WOOD AND WOOD PRODUCTS

Senator COCHRAN. What about extending the Export Credit Guarantee Program and the Intermediate Credit Guarantee Program to wood and wood products? I have had some interest expressed to me in extending those programs to the export of wood and wood products. Have you given any consideration to this, Secretary Amstutz?

Mr. AMSTUTZ. An enormous amount, Senator. The problem is a technical one as to whether wood products are manufactured products. And if they are manufactured products, we have some multilateral problems on credit extension.

I believe there has been an amendment to trade legislation introduced either on this side or in the House that would identify wood products as nonmanufactured. I am not a lawyer, Senator. I don't know whether that would do it.

Senator COCHRAN. Well, I don't know the answer to it either. But that is the dilemma.

Mr. AMSTUTZ. We are totally sympathetic with the desire of the industry, but we have the problem of identification and multilateral obligation.

IMPACT OF REDUCTION IN CREDIT GUARANTEE PROGRAM

Senator COCHRAN. My next question is for the General Sales Manager. The 1985 farm bill established a $5 billion program for the short-term export credit guarantee program, GSM–102. Legislation is being proposed to reduce that level to $3 billion. Mr. Sims' statement indicates that we made available $4.2 billion of short-term guarantees for a variety of commodities and that exports valued at more than $2.5 billion were registered under that program. You also indicate that we have already announced $3.7 billion of short-term guarantees available for 27 countries.

What is the practical impact of a $2 billion cut in that program?

Mr. SIMS. Senator, for the last 2 years, even though we have made higher levels of guarantees available by announcing it, the amount of exports that has actually been registered has been $2.5 billion for 2 successive years. For fiscal year 1988, we are proposing $3 billion in short-term and another $500 million in intermediate-term credit guarantees giving a total of $3.5 billion.

We think that will probably satisfy the demand. The registrations so far this year are running quite comparable to those of the previous year, so we anticipate that we will probably not need that amount.

Now should we foresee an increase in demand—and we hope that we would see that—if that should occur, we could, I think, come back and provide additional resources. But as of now, we feel comfortable with the total amount of $3.5 billion as being available.

SPECIAL FOREIGN CURRENCY

Senator COCHRAN. Thank you.

I would like to direct this to Dr. Wallace. In your explanatory notes there is an indication that the Special Foreign Currency Program is again being proposed for elimination because of the reduced number of countries where the United States owns excess foreign currencies. I believe USDA has unique authority, however, and is not restricted to working only in countries where there is an excess currency situation. Could you describe this expanded authority? And, what are some of the excess currency countries? For the record, it would be good to have a list of those countries where foreign currencies could potentially be available through USDA's expanded authority.

Dr. WALLACE. Senator, we do have expanded authority, and it is true that the number of countries which have excess currency is only four. But the expanded authority is for a number of countries, it is anywhere funds are owned by or owed to the United States. For example, we are using funds in Costa Rica now to study the fruit fly and to work on some of the problems with the fruit fly in the Caribbean. We can use what is called cup funds. These are the funds that are used to pay for embassies and a variety of other U.S. expenses.

We can use these funds in any country where there is currency owed or owned by the United States.

[The information follows:]

Excess Currency Countries

1983	1984	1985	1986	1987
India	India	Poland	Poland	Poland
Pakistan	Pakistan	Pakistan	Pakistan	Pakistan
Burma	Burma	Burma	Burma	Burma
Guinea	Guinea	Guinea	Guinea	Guinea

Near-Excess Currency Countries

1983	1984	1985	1986	1987
Taiwan	Czechoslovakia	Ghana	Ghana	India
Yugoslavia	Egypt	Sudan	Sudan	Sudan
	Ghana	Taiwan	Taiwan	Taiwan
	Poland		India	
	Sudan			
	Yugoslavia			

Currency Use Provision (CUP) Countries -- 1987 availabilities

- Costa Rica
- Dominican Republic
- Ecuador
- Egypt
- Ghana
- Guatemala
- Guyana
- Indonesia
- Kenya
- Mozambique
- Peru
- Philippines
- Sierra Leone
- Somalia
- Sri Lanka
- Tunisia
- Yemen
- Zaire
- Zambia

MIDDLE INCOME TRAINING PROGRAM

Senator COCHRAN. Could you give us an update on the Middle Income Country Training Program—whether or not U.S. and foreign groups continue to support the program? And if so, why?

Dr. WALLACE. Well, the Middle Income Country Training Program, as you know, Senator, has been continuing for 4 years. Last year, we had eight countries involved in it. We had 215 participants. Because the countries are now paying their own airfares, more of the $1.5 million appropriation is available for tuition or other training fees. About 98 percent of the training requests are for short-term courses. We only have about 2 percent of the participants in long-term Ph.D. or Masters programs.

We have worked with a large variety of cooperators, including the American Soybean Association, the National Renderers Association, Inc., USA Poultry and Egg Export Council, U.S. Feed Grains Council, and the National Sunflower Association. About 13 cooperators have participated with us.

The program has, as you may remember, involved the agricultural attaché in that country. The attaché works with the private sector to choose participants who can help us with our exports. It has opened doors.

We have seen the program as a model program over this period of time, and it has given us the opportunity to both try it out and evaluate it.

We do receive cables from countries asking for this kind of activity.

Senator COCHRAN. You mentioned that the American Soybean Association, the sunflower growers, and others, are participating in the program. What do they do? How do they participate in the program?

Dr. WALLACE. Well, in most of the countries where the cooperators have offices, they have participated in choosing the applicants. They have recommended applicants to us—men and women who have been working in areas of interest to the cooperators—to give them the opportunity to have, for example, a short course in grain handling and a variety of other activities.

Senator COCHRAN. Do you get any contribution of funds from these groups?

Dr. WALLACE. We have received some in-kind contributions. I believe the U.S. Feed Grains Council, for example, has contributed time in teaching, particularly, as well as providing other program components such as field trips.

INTERNATIONAL SCIENCE AND EDUCATION COUNCIL

Senator COCHRAN. The International Science and Education Council, I know, is involved in providing guidance to USDA's research, training, and technical assistance programs, and it coordinates university involvement. What impact would the proposed reduction in funding that is included in this budget request have on the ISEC activities?

Dr. WALLACE. Well, the program has been funded minimally in the past. We have had about $100,000 as a budget. We would probably reduce that by one-half. Those funds have paid for a variety of activities. Mostly ISEC is a planning group, which Dr. Rouse Caffey, who is the Chancellor of Louisiana State University and I cochair.

What will happen? What we have done in the past is to have research management activities in the Virgin Islands for members of the Caribbean countries as a part of the Caribbean Basin activity. We have had a national training conference here in Washington, bringing all the university people together.

We would cut down on our activities.

Senator COCHRAN. Mr. Chairman, those are the questions that I have. Thank you very much for recognizing me.

Senator BURDICK. Thank you.

IMPORT PROTECTION AND MARKET SHARE

In recent years, U.S. agricultural exports have declined. At the same time we have seen an increase in imports and a pressure for more protection for U.S. producers. Would revisions in general import protection measures assure U.S. producers a greater share of the export market?

Mr. AMSTUTZ. Is that your question, Mr. Chairman? Is that your question, would they?

Senator BURDICK. Yes.

Mr. AMSTUTZ. We think not. And we think, as I alluded to previously in response to another question you raised, in order to sell, one also has to be willing to buy. One has to believe in the concept of trade. These days there is a popular word around, reciprocity. And while we would have some difficulty with the literal translation of reciprocity because that can cause problems, we philosophically think that if we want countries to buy our goods we have to be prepared to buy from them as well.

The significant reason for the narrower trade balance figures in agriculture these years versus past years, is that per unit prices of some of the major export commodities from the United States have gone down. And per unit prices of some of our major imports have been quite high. Coffee prices per pound, for example, this past year have been high on a historical basis. And prices for corn and wheat per bushel have been low on a historical basis.

The tonnage figures are far more dramatic as a positive trade balance than these dollar figures have been because of the per unit price anomolies.

Senator BURDICK. And I belong to your school too of that theory. But what do I see today? I see imports increasing, and agricultural exports decreasing. There is something wrong here.

U.S. EXPORTS INCREASING

Mr. AMSTUTZ. Well, I think the record shows, Mr. Chairman, that our exports are increasing this year, and in some areas rather dramatically. In the area of high value products—our vegetable, fruit and nut crops—those increases are really dramatic, anywhere from 30 to 50 percent increases.

And we are beginning to see a turnaround in our exports of wheat. The latest projections on corn are really quite promising, and, of course, so far this year the exports of soybeans and soybean products have been quite high. Cotton exports are up, as are rice.

So this year, fiscal year 1987, we are enjoying an increase in our exports. And Mr. Kay just gave me a note that our imports this year—the other side of the ledger—our imports so far this year are down 12 percent versus our estimate. So there is some decline on our imports and some increase on our exports. The positive trade balance for agriculture is clearly widening on a tonnage basis.

Senator BURDICK. Well, I hope you are right. We will look at it again the next time you come before the committee.

Mr. AMSTUTZ. Fine, Mr. Chairman.

Senator BURDICK. In your statement, Mr. Kay, you mentioned a $3.4 million increase composed of $1.8 million for pay costs and the Federal Employees Retirement System, and $1.6 million for increases in overseas operating costs. You say that you will offset the remaining increased costs through selected reductions in your overseas presence. What are the other increased costs that you will offset?

EXCHANGE RATE LOSSES

Mr. KAY. The basic problem we have, Senator, is the devaluation of the dollar overseas. The Japanese yen is certainly an outstanding example of that. Two years ago the yen was 245 to the dollar. Yesterday it hit the low of 145. We spend around $21 million per year on our overseas operations, and that, of course, involves expenditures for payments to foreign nationals, rental space where we don't have housing in the embassies, the utilities, equipment, as well as reimbursement of the State Department for administrative functions which they perform for us.

Most of these kinds of expenditures overseas are in local currency. We have had a loss of at least $2 million in purchasing power overseas just since the 1987 budget was submitted to the Congress. And, as I said in my statement, we are faced with the possibility of having to close out some of our offices overseas, perhaps as many as 13 and reducing staff in at least five others.

Senator BURDICK. We just got word, Mr. Amstutz, that you are wanted over on the House side.

Mr. AMSTUTZ. I have a problem.

Senator BURDICK. We will excuse you.

Mr. AMSTUTZ. Thank you very much, Mr. Chairman. It was good to be up here today.

Senator BURDICK. Your lieutenants will take over for the next 15 minutes or so.

REDUCTIONS OVERSEAS

Your budget maintains 266 overseas staff-years at an increase of $1.3 million. Why will your presence overseas be diminished?

Mr. KAY. I didn't understand your question, Senator.

Senator BURDICK. Your budget maintains 266 overseas staff-years at an increase of $1.3 million. Why will your presence overseas be diminished? You have got an increase there.

Mr. KAY. Well, the staff-years overseas, Senator, if I remember my figures correctly, would not be that many. We would have about 241 people overseas, which includes foreign nationals, our professional people from FAS, and the clerical help. Ninety-five of that total amount are our FAS personnel. And we just went through an overseas staffing review with the State Department, and we lost our professionals in Bangladesh, and we are now transferring our trade officer from

Tunis to Algeria. And the money you referred to in that figure is basically to care for inflation overseas which the Congress has seen fit to give us from time to time. The inflationary factor is further complicated by the devaluation of the dollar.

Senator BURDICK. Do you expect that you will have to modify your budget request for fiscal year 1988 if this trend continues, the value of the dollar?

IMPACT OF EXCHANGE RATES ON THE FAS BUDGET

Mr. KAY. Senator, when we submitted our 1988 budget to OMB we did ask for a supplemental to take care of this problem. OMB, however, instructed that we would be given discretionary authority to reprogram our funds in language that was to be sent to the Hill. And, quite frankly, there are really no funds to be reprogrammed. We have cut our travel expenses. We have cut our equipment expense, and we are attempting to update our electronic reporting equipment. And we have not hired any additional personnel. So we are faced with a possibility, as I said, if we don't have a supplemental for 1987 for some $2 million that we will have to close those posts.

Now I second what Mr. Amstutz said, Mr. Chairman, about the budget deficit contributing to the overall problem of agricultural exports. And we certainly support the President's budget, but at the same time I feel that in all honesty I have to point out to you the consequences that come if we don't get some relief in this area. And this is not to say that the world won't get along without us. But it is to say that I feel very keenly that it sends the wrong signal to our producers, and it sends the wrong signal to our competitors, when we are forced to retrench at this point in time.

TRAINING PROGRAMS

Senator BURDICK. My next question is for Dr. Wallace. The middle income country training program provides foreign students placement at agricultural study centers and universities throughout the United States. If this program were terminated, would there be any other educational program at which foreign nationals might receive assistance in obtaining an education in the agricultural sciences in the United States?

Dr. WALLACE. Mr. Chairman, we have a program which is funded by U.S.A.I.D., and 2,000 foreign agriculturalists go through our doors every year. These agriculturalists are from the less developed countries. They are the AID countries. These participants go to the universities.

The middle income training program includes what we consider middle income countries which do not receive aid. They include the Koreas, the Venezuelas, the Mexicos, the Yugoslavias, the Iraqs. Those are the countries from which these participants come.

And the answer to your question is, for that group, there would be no other training funds available.

Senator BURDICK. Your testimony notes that each academic student brings about $20,000 annually to the United States through tuition and living expense payments. Could it be said that this is the only value of the middle income training program or are there other long-term benefits that can be counted?

Dr. WALLACE. We hope that that is not the only value, sir. We feel that the middle income country participants who come to the United States are chosen by our commodity groups, or by our agricultural attachés because they are people who will have influence on trade. And we are hoping that this program will help to increase trade.

We have had a member of the group from Venezuela return to the United States to purchase cattle and embryos. He established a laboratory in Venezuela where he is indeed continuing to purchase from the United States.

In addition, the program was thought to be competitive with the Soviet bloc countries' program. The Soviet Union has a university called Patrice Lamumba University for poor persons from the Third World, and they are spending large amounts of money to bring Third World participants to the Soviet Union. This middle income country program, as I said, has created a model, and we hope that this will make a difference in foreign affairs as well as in trade.

BUDGET REDUCTION IMPACT

Senator BURDICK. The fiscal year 1988 budget request includes reductions of $198,000 for international agriculture and development, and about $216,000 for development, planning and analysis. Please explain how this funding has been used during the past fiscal year and whether activities that it has supported will be terminated or absorbed by AID or other agencies of the USDA.

Dr. WALLACE. In 1986 there was $200,000 for an agribusiness information center, which Congress put into our budget in order to help those agribusinesses which are particularly interested in investment, in trade. Most of the people from the Caribbean Basin are interested in small businesses, but they have no idea what they can bring into this country or how they can invest in other countries. The center has become a one-stop, computerized source of answers to the numerous questions we get every day from agribusinesses.

Additionally, there is about $100,000 for the International Science and Education Council, which I mentioned to Senator Cochran. This Council is cochaired by me and Rouse Caffey, who is Chancellor of Louisiana State University. That group works in planning some of the programs in technical assistance, training, international research, international organizations, and our scientific exchange.

In addition, they have some special programs of their own which include the research management and training seminars. A recent seminar brought all the land grant colleges and universities to Washington to work toward innovative techniques in international training.

If we cut that, we would be cutting the activities of that group.

We also have one person on our staff who evaluates Public Law 480 self-help projects, coordinating with FAS and U.S.A.I.D., in reviewing those projects for Public Law 480 assistance.

Senator BURDICK. My next question is about Public Law 480.

The Food Security Act of 1985 required progressive increases in the quantities of Public Law 480 and section 416 cargo that must be shipped in American flagships. Any increase to ocean freight charges require about 50 percent of the cargo preference carrier requirements by law to be paid by the Department of Transportation.

Has the Department of Transportation been incurring the cost for transportation due to the increase in cargo preference of about 50 percent? If not, has CCC paid this amount?

FINANCING CARGO PREFERENCE

Mr. SIMS. So far, Commodity Credit Corporation has paid it. We are in the process of working out a memorandum of understanding, and we have been submitting bills to the Department of Transportation. We think that within the near future that memorandum will be executed, and we expect to receive payments for the amount we have advanced.

Senator BURDICK. Why has CCC been paying these costs? What statutory grounds and from what account?

Mr. SIMS. Well the law says that the cargo preference will go up. And so we have increased it from 50 percent up to 60, and it will go up to 70 percent April 1. And since the Public Law 480 account comes out of CCC funds, accounting-wise, we have gone ahead and advanced the moneys and are asking for reimbursement.

Senator BURDICK. You are aware what the law says. It says the Department of Transportation should pick up these costs.

Mr. SIMS. Yes.

Senator BURDICK. Then why are you picking them up?

Mr. SHERMAN. Mr. Chairman, if I might comment on that.

Senator BURDICK. You might.

Mr. SHERMAN. The funds provided for the Public Law 480 program are transferred to the Commodity Credit Corporation, and they are the agency that does the paying for all the transactions. In this case, we are paying for all the costs, including the shipping cost, and we are working with the Department of Transportation on an agreement to reimburse us and replenish those costs to the Corporation. So there will still be the payment by the Department of Transportation. The payment now and the reimbursement from Transportation is merely a financing transaction.

REPAYMENT FROM DEPARTMENT OF TRANSPORTATION

Senator BURDICK. How much have you received from the Department of Transportation?

Mr. SHERMAN. None to date.

Senator BURDICK. That is right.

How much have we paid in charges that should have been theirs?

Mr. SIMS. Well it is—an up-to-date accounting would be somewhere between $15 and $20 million.

Senator BURDICK. You have paid it all and you have not been repaid.

Mr. SHERMAN. Mr. Chairman, I believe one of the issues that is in discussion in arriving at the agreement with the Department of Transportation is, is it on each shipment that a portion is paid by Transportation? Is it the first group of shipments or the last group of shipments for the year? Those are some of the more detailed technicalities that need to be resolved, I believe, in getting the signed agreement. I think that is the reason why it has been delayed at this point. We will still proceed with that and we will have them get an agreement completed so that the payments are made in the provisions under the law before the end of the year.

Mr. SIMS. We have notified them that if it is not paid by the end of this month, interest will start accruing.

Senator BURDICK. The $15 million will be paid to you?

Mr. SIMS. Right now, I believe we have actually billed them for about $12 million, but there is additional that is in the process of being billed.

Senator BURDICK. I think it would be simpler if you would let them pay the bills in the first place.

Mr. SIMS. I guess some of us would not necessarily resist that.

ACCOUNTING FOR CARGO PREFERENCE CHARGES

Senator BURDICK. Are amounts paid by CCC to comply with the cargo preference requirements charged against Public Law 480 or section 416 program ceilings?

Mr. SIMS. The ocean freight differential is charged against the Public Law 480 budget. The section 416 ocean freight differential is paid for in commodities essentially. It is paid by CCC, but it does not come out of the Public Law 480 budget. That is a separate account.

We are getting into some accounting questions here that I need some help with. Maybe we can provide the answer to that specifically.

Senator BURDICK. It would be fine if you would.

Mr. SIMS. Yes.

Senator BURDICK. For the record.

[The information follows:]

FUNDING OF OCEAN FREIGHT DIFFERENTIAL

The Food Security Act of 1985 requires an increase in the minimum tonnage of commodities provided through U.S. food aid programs which are shipped on U.S. flag vessels. This minimum tonnage is to be increased from 50 to 75 percent over a 3-year period. The Food Security Act also provides that the increased costs which result from this expansion of cargo preference are to be paid by the Department of Transportation.

In the case of the Public Law 480 program, the Public Law 480 account will continue to fund the ocean freight differential costs for the first 50 percent of program tonnage which moves on U.S. flag vessels. The Department of Transportation is responsible for paying the differential for the Public Law 480 tonnage which moves on U.S. flag vessels above the basic 50 percent level. The Department of Transportation will pay for its share of these costs on a reimbursable basis to the Commodity Credit Corporation [CCC].

Under the section 416 program, CCC funds are used to meet the costs of ocean freight differential on 50 percent of the program tonnage which moves on U.S. flag vessels. As in the case of Public Law 480, the Department of Transportation will meet the costs of the differential as the U.S. flag percentage increases above 50 percent and this will be accomplished on a reimbursable basis with CCC.

The Department of Agriculture has reached general agreement with the Department of Transportation on procedures by which Transportation will reimburse CCC for the increased costs of cargo preference. Under the terms of the agreement, CCC will bill the Department of Transportation for its share of the costs of cargo preference within 45 days after the end of each quarter. Transportation is required to reimburse CCC within 45 days of the date of billing, provided that CCC has advised the Department of Transportation that at least 50 percent of the estimated annual Public Law 480 and section 416 tonnages have been shipped on U.S. flag vessels. This 50 percent determination is made on the basis of an April 1 to March 31 annual cargo preference year as established by the Food Security Act.

PUBLIC LAW 480 SHIPMENTS FROM GREAT LAKE PORTS

Senator BURDICK. The Food Security Act of 1985 granted the Great Lakes region a set-aside for Public Law 480, Title II shipments. Regulations issued on February 25 of this year by CCC interpret the set-aside as being subordinate to or limited by cargo preference requirements.

What Great Lakes ports will be handling Public Law 480 commodities as a result of bidding as required in fiscal year 1987?

Mr. SIMS. As you may know, title II is handled primarily by AID. They are the lead agency on that. And ASCS is the one that arranges for that shipping. So we will have to provide the answer for the record for that as well.

Senator BURDICK. That would be fine.

[The information follows:]

The specific U.S. ports that handle Public Law 480, Title II commodities are determined on the basis of available ocean service and lowest landed cost factors, including the cargo preference requirement. In the case of commodity procurements, the commodity supplier names the U.S. port of delivery. Therefore, we do not know the specific ports that will be handling Public Law 480 commodities in 1987. The following Great Lakes ports handled Public Law 480, Title II cargo in recent years: Duluth, MN, Green Bay, WI, Kenosha, WI, Burns Harbor, IN, Superior, WI, Milwaukee, WI, and Chicago, IL.

Senator BURDICK. Is that true of the next question? What Great Lakes ports will not be handling Public Law 480?

Mr. SIMS. Yes, sir; that would be. We will provide that information for the record.

[The information follows:]

The list of ports provided for the record for the previous question includes all the Great Lakes ports handling Public Law 480, Title II cargo. CCC, however, does not control participation of ports. Ports must be bid as delivery points by commodity suppliers and must offer ocean service to program destinations to be considered for use in the competitive award process.

Senator BURDICK. Thank you.

What is the total amount of grain and the percentage of Public Law 480 commodity that should be set aside for the Great Lakes based on fiscal year 1987 estimates? Do you expect to meet these levels?

Mr. SIMS. The title II programs are not the bulk grain programs primarily. Most of that moves under title I. We will have to get that answer for you.

Senator BURDICK. All right.

[The information follows:]

The Food Security Act of 1985 added key provisions to the Merchant Marine Act that apply specifically to the Public Law 480 and section 416 agricultural commodity export programs. One of the provisions that applies to the Public Law 480, Title II program is an apparent Great Lakes reserved tonnage clause. Under this provision the Great Lakes is to receive, without detriment to other port ranges, the metric tonnage, or percentage share, of the commodities that was shipped by waterborne export through the Great Lakes in 1984. In 1984, about 245,000 metric tons of title II processed, bagged and fortified commodities were allocated for shipment from the Great Lakes. A portion of this was exported from the east coast due to the collapse of a drawbridge at the end of the lakes season. On a 12-month basis, the metric tonnage represents about 20 percent of the total 1984 title II processed, bagged, and fortified commodities, for 24 percent of the total if computed only for the 9 months that the Great Lakes are open. The Department is making every effort to comply with the law.

SUBMITTED QUESTIONS

Senator BURDICK. We have some additional questions to be submitted for the record, and they will come from Senators Burdick, Sasser, Grassley, McClure, and Domenici. We would appreciate it if you would respond to them in an expeditious manner.

[The following questions were not asked at the hearing but were submitted for response for the record:]

FOREIGN AGRICULTURAL SERVICE

QUESTIONS SUBMITTED BY SENATOR BURDICK

U.S. AGRICULTURAL TRADE BALANCE

Between 1974 and 1985, the U.S. Agricultural Trade Balance represented an annual contribution of $10 billion to $25 billion. In fiscal year 1986, this contribution to the overall U.S. trade balance fell to $5.4 billion, and according to USDA estimates, is expected to reach only $6.0 billion in fiscal year 1987.

Question: In what parts of the world may we expect to gain entry and secure expanded export markets in the next fiscal year?

Answer: In Turkey, despite a recent increase in domestic soybean production, the country's rapidly rising feed requirements could result in greater imports of U.S. corn, soybean meal and soybeans. Turkey's expanding poultry and livestock sectors have raised possibilities for greater U.S. exports of baby chicks and cattle. There also is a growing demand in Turkey for vegetable oils, particularly soybean oil, a major ingredient for margarine production. Upon removal of high import surcharges, U.S. exporters of soybean and other vegetable oils could enter the Turkish market.

In the Middle East, the new U.S. Dairy Export Incentive Program could well create an opportunity for increased U.S. sales of cheese to Egypt, Kuwait, Jordan, Tunisia and Yemen. Under the program, U.S. cheese exports could compete effectively with subsidized EC sales and exports from Australia and New Zealand. The same program could lead to increased sales of non-fat dry milk to Algeria and the Gulf Cooperation Council.

In 1987, U.S. exports to Senegal are expected to grow, thanks to recent wheat sales under the Export Enhancement Program--EEP--and growing consumer acceptance of P.L. 480 long rice.

As a result of trade discussions with Taiwan in 1986 which resulted in the liberalization of cigarette, beer and wine imports, we expect significant export growth in fiscal year 1988 as Taiwanese consumers become familiar with U.S. products. Lower duties effective January 18, 1987, on 32 agricultural and forestry items of interest to U.S. exporters, including almonds, apples and plywood can also be expected to stimulate consumer demand.

Our expectations are for some fiscal year 1988 trade gains in Korea resulting from the licensing liberalization of lemon and cranberry juice, tariff reductions on raisins, almonds, cherries, canned corn, chocolate and chocolate confectionary and the granting of a 10,000 metric tons quota for alfalfa which will take effect on July 1, 1987.

Japan stands out as an area where we can expect expanded markets in the next fiscal year. Reduced tariffs became effective April 1, 1987, on a number of forest products and wine. We will expect substantial increases in beef and orange exports once our current agreement expires March 31, 1988. We also are discussing increased access for a range of other products, including rice.

In China, we have already seen an increase in wheat sales this year as a result of the extension of the EEP program. We are also expecting to see increases in wood products.

In the EC and Western Europe, we will do well to maintain our markets in the face of domestic policies which continue to encourage home production at the expense of imports. On the positive side, however, we can point to concessions made by the EC in the citrus agreement for oranges, lemons, grapefruits, orange juice and in the enlargement agreement for a number of high value products where we would expect to increase our exports.

Question: What efforts are being undertaken to gain access to markets in Western Hemisphere in addition to Mexico, Venezuela, and Brazil?

Answer: In the Western Hemisphere our major efforts are currently being directed at Canada with whom we are negotiating a free trade agreement. We are striving for an agreement which will deal with both tariffs and non-tariff barriers. We have working groups dealing specifically with agricultural access issues, technical barriers to trade and agricultural subsidies. In Latin America outside the countries mentioned, we remind the Chileans at appropriate occasions that we would like to see them modify their import system for wheat and vegetable oils. We have also, through consultations and the GSP review process, persuaded Colombia to ease restrictions on apple licenses and to enter into consultations on technical barriers to wine trade.

Question: What commodities do you envision will benefit from increased export enhancement activities?

Answer: Sales under the Export Enhancement Program--EEP--represented close to three percent of the value of total U.S. agricultural exports in fiscal year 1986. The EEP will continue to benefit the same commodities as in its first 18 months. Wheat and flour have accounted for the majority of the initiatives in terms of volume, followed by barley. Other commodities that have been found to fit the criteria of the EEP, and which will continue to be available under already announced programs are rice, frozen poultry, barley malt, sorghum, semolina, eggs, dairy cattle, poultry feed, and vegetable oil. It is possible that other commodities could be added to the list, and these are being reviewed in light of changing circumstances.

UNFAIR TRADE PRACTICES

Question: Are we in the midst of a trade war in which unfair trading practices are giving other nations a competitive advantage edge over the U.S.? What can we do about it?

Answer: It is an over-generalization to state that the United States is in the midst of a trade war with other countries. The United States has been faced with intensified competition both domestically and abroad. However, we have challenged and will continue to attack the use of unfair trade practices that adversely affect U.S. trade wherever they exist. Our best prospects for achieving improved market opportunities and fairer international trade rules are through the multilateral trade negotiations that were launched in Uruguay in September, 1986. The objectives of the agricultural negotiations are to seek improved market access, increased discipline over the use of all subsidies, improved procedures to minimize the adverse effects of health and sanitary restrictions, and a strengthened dispute settlement process. Our goal is to obtain agreement by all countries to phase-down all trade restrictive and trade distorting measures, and reduce government involvement in agriculture worldwide.

EXPORT POLICY INITIATIVES

Question: In general, should new policy initiatives be implemented to encourage more exports? If so, what type of initiatives?

Answer: U.S. agriculture cannot reach its full export potential until fairness in the world market is ensured. Therefore, this Administration is committed to comprehensive negotiations for the elimination or reduction of restrictive trade practices abroad. The Uruguay Round of multilateral trade negotiations represents the best new opportunity we will have in this decade for developing ground rules that will facilitate trade in agricultural products. However, this will not be a quick fix. These results will take time to implement. In the meantime, the Administration will continue to pursue policies that enhance trade opportunities, including the use of the Export Enhancement Program and other export tools and programs at our disposal.

ADDITIONAL FISCAL YEAR 1988 FUNDING

Question: Would additional funding for existing programs provide greater access to export markets for U.S. products?

Answer: The Administration has submitted to the Congress two fiscal year 1987 supplemental funding requests. One supplemental request would provide for funds to be reprogramed to offset increased overseas operating costs due to exchange rate losses. The other supplemental requests $705,000 for staff to help implement programs mandated by the Food Security Act of 1985. These funds will carry into fiscal year 1988 to help meet funding requirements. Our fiscal year 1988 budget requests funding consistent with market opportunities and the critical need to manage the Federal budget deficit.

VALUE OF THE DOLLAR

Question: In what areas of the world has the decline in the value of the dollar affected operations most severely?

Answer: The sharp decline in the value in the dollar has occurred mainly in Europe and Japan. Since March, 1985, the dollar has dropped 48 percent, resulting in an annual cost increase in Attache and Agricultural Trade Office operations of approximately $2.5 million.

Question: Do you expect that you will have to modify your budget request for fiscal year 1988 if this trend continues?

Answer: If the value of the dollar should continue to decline, we would have to consider either submitting a budget supplemental or further reduce our overseas operations.

P.L. 480 AND SECTION 416

The Food Security Act of 1985 included several provisions for strengthening U.S. foreign food assistance programs carried out under P.L. 480 and Section 416 of the Agricultural Act of 1949.

Implementation of these provisions is shared by USDA and other agencies through the Development Coordination Committee.

Question: How has the interagency coordination committee worked to implement expeditiously the provisions of the 1985 Farm Bill?

Answer: Working level members of the Food Aid Subcommittee formed ad hoc sub-groups, under general USDA direction, to work out implementation of the food aid measures in the farm bill. Those sub-groups then started a series of frequent meetings to identify issues and work out procedures until the programs were in place. While the Food Aid Subcommittee agencies' representatives in the sub-groups frequently served on more than one sub-group, specialized personnel from those and other affected agencies were also brought in to specific groups where additional expertise was needed. For example, the sub-group on the private sector initiative--section 108 of P.L. 480--involved participation from the Overseas Private Investment Corporation, fiscal experts of the Commodity Credit Corporation, and foreign currency experts from the Treasury Department. But none of those officers were needed for the Food for Progress sub-group, which had additional participation from the State Department, the Office of Management and Budget, and the Agency for International Development.

Question: Will the legislative goal of a minimum of five percent of the aggregate value of Title II and Section 416 commodities provided in fiscal year 1987 be monetized?

Answer: Based on Title II agreements signed and those pending for fiscal year 1987, we anticipate achieving the mandated level of monetization. Under Section 416, we have only two agreements signed with monetization provisions. Due to the small number of agreements signed, we may not achieve the mandated level.

VALUE OF NON-EMERGENCY COMMODITIES

Question: What is the estimated value of non-emergency commodities channeled through these programs for fiscal year 1987?

Answer: To date there are Title II non-emergency approvals totaling more than 1.1 million metric tons at an estimated value of $251 million. Thus far in fiscal year 1987, we have signed Section 416 agreements committing over 500,000 metric tons of non-emergency commodities at an estimated value of $112 million. Section 416 program proposals under review and being developed can increase the value by more than $60 million.

VALUE OF MONETIZATION PROPOSALS

Question: What is the value of monetization proposals under these programs received for fiscal year 1987?

Answer: For fiscal year 1987, 27 Title II monetization proposals with a commodity value of $11.4 million have been received for activities in 19 countries. Two Section 416 proposals with a monetization component valued at about $1.3 million have been received and were approved.

Question: How many of these proposals have been approved?

Answer: To date the Title II Food Aid Working Group Subcommittee of the Development Coordinating Committee has authorized 15 proposals. Two Section 416 agreements were approved and signed. One with CARE/Mexico and the other with SHARE/Guatemala.

Question: What is their value?

Answer: The Title II proposals total $6.1 million or 2.7 percent of the value of non-emergency Title II activity. The CARE/Mexico monetization component is $1.1 million and the SHARE/Guatemala component is about $200,000.

Question: How close does this come to meeting the five percent minimum requirement established by law?

Answer: Section 1104 (b) of the Food Security Act of 1985--adding a new Section 207 to P.L. 480--requires that agreements with nonprofit voluntary agencies for commodities distributed under non-emergency food assistance must provide for the use of foreign currency proceeds in an amount not less than five percent of the aggregate value of commodities distributed under non-emergency programs under Title II. A 2.7 percent level has been reached to date in fiscal year 1987; we will continue to refine pending proposals and encourage new proposals in order to achieve the mandated level by year's end.

Section 1109 (2) of the Act--amending Section 416 (b) of the Agricultural Act of 1949--requires that for each fiscal year not less than five percent of the aggregate value of commodities provided under Section 416 (b) to nonprofit and voluntary agencies and cooperatives be provided for subsequent sale except to the extent that there are insufficient requests or with respect to commodity availability. Section 416 agreements signed with CARE/Mexico and SHARE/Guatemala include the small monetization components previously mentioned. Because of insufficient requests, we may not meet the five percent target in fiscal year 1987.

CURRENCIES GENERATED UNDER P.L. 480 AND SECTION 416

Question: Has the interagency committee provided guidelines for private voluntary organizations working abroad relating to the purposes for which local currencies generated under P.L. 480 and Section 416 can be used?

Answer: The interagency committee has sent cables to the field for AID field staff and the private voluntary organizations defining monetization of project food aid and requesting proposals from the private voluntary organizations. Draft policy guidelines on monetization have been shared with the private voluntary organization community.

Question: What are the priorities established and the rationale for these priorities?

Answer: The priority uses established by these directives include costs associated with transport and storage of project food aid commodities and ancillary costs which enhance the basic objectives of the project. These uses are important for two reasons.

Logistical costs can represent the major costs of a project. These costs can be prohibitively high, particularly in the least developed areas of the world. For a food aid project to achieve its objectives, the food must reach the intended recipients. Where no other resources are available, monetization provides one means of project support in this vital area.

Frequently, food alone cannot ensure that project objectives will be met. Non-food resources--such as shovels for Food for Work, scales for Maternal Child Health, and books for School Feeding Programs--are generally necessary to meet project goals. Again, monetization is one means of providing these inputs.

PURPOSES OF MONETIZATION PROPOSALS

Question: For what purposes have monetization proposals been approved in fiscal year 1987?

Answer: Monetization proposals have been approved in fiscal year 1987 for internal transportation, warehousing and related distribution costs.

Question: Why haven't proposals requesting monetization for purposes, other than transportation, such as development, been approved?

Answer: The interagency committee has approved monetization programs in Bolivia which will enhance development. A program managed by Catholic Relief Service will enhance the development impact in agricultural promotion, small enterprises, preventive health care and program support. A program managed by Adventist Development and Relief Agency will enhance the development impact including increased nutritional education services and provide complementary resources to food for work programs and provide health services. A program managed by Food for the Hungry, Inc., will enhance the development impact in projects that include micro irrigation, family centers, water wells, flood prevention dikes and potable water.

TONNAGE REQUIREMENTS

Tonnage requirements for nonprofit voluntary agencies, cooperatives, and the World Food Program were increased to 1.4 million metric tons for fiscal year 1987 through the Farm Bill.

Question: What priorities have been established for use of these additional commodities?

Answer: There has been a concerted effort to meet this congressionally mandated minimum tonnage. The World Food Program component of regular program activity will be nearly 400,000 metric tons. This level of World Food Program activity is compatible with our commitment under the U.S. pledge.

REQUIREMENT GUIDELINES

Question: Has USDA worked to assure that private voluntary organizations will receive guidelines for their use?

Answer: In anticipation of difficulty in meeting this requirement, the private voluntary organization community has been encouraged to submit new proposals. Rising costs of transport and implementation as well as those associated with better targeting and increased developmental focus have made expansion difficult.

Question: What countries will these commodities be sent to during fiscal year 1987?

Answer: The Interagency Committee is encouraging new project start-ups in Africa. In addition, we are maintaining support to our longer term efforts in Asia and Central/Latin America.

LOCAL CURRENCIES GENERATED BY TITLE I SALES

Question: What is the level of local currencies generated by Title I sales for private enterprise lending programs under Section 106 or 108 programs in fiscal year 1987?

Answer: At this point in fiscal year 1987 we have signed an amendment to a fiscal year 1986 agreement with Tunisia, to include local currency financing. We also signed fiscal year 1987 agreements with Jamaica, Costa Rica, and Sri Lanka. The total value of local currency financing for these four countries is $14 million.

Question: Have there been any obstacles in developing these programs?

Answer: Yes, this was a complex program to develop. We had to address concerns of more parties than are usually involved in Title I programs. Groups who do not normally participate included Overseas Private Investment Corporation, the Trade and Development Program, and AID's Private Enterprise Bureau.

This program involves participating countries' financial sectors and monetary policies, multiple U.S. agency objectives, transfers of currencies and dollars between the U.S. Government and participating country governments, and among U.S. Government agencies. Operating procedures had to be developed that met the program and legal requirements of these various interests.

P.L. 480 TONNAGE REDUCTION

Question: Why does USDA recommend a reduction in the amount of available P.L. 480 tonnage to be shipped from 8.3 million metric tons in fiscal year 1987 to 7.8 million metric tons in fiscal year 1988?

Answer: While the 1988 proposed level represents a reduction from the amount available in 1987, total P.L. 480 tonnage expected to be shipped in 1988 would be well in excess of the average annual volume of commodities made available through the program in the early 1980's, when programming averaged 6.0 million metric tons annually. In addition, the level of U.S. foreign food assistance in 1988 will be augmented by donations from CCC-owned stocks through the Section 416 program.

MINIMUM TONNAGE LEVELS

Question: Is it not true that Section 416 establishes minimum tonnage levels for commodities from surplus stocks to be shipped in each fiscal year 1986, through 1989?

Answer: There are no minimum tonnage donation levels for shipment under Section 416, however, the Food Security Act of 1985 did mandate minimum tonnage levels for commodities to be made available for donation. These minimum levels are 500,000 metric tons of grains and oilseeds, and 150,000 metric tons of dairy products.

Question: Were these minimum tonnage levels met in fiscal year 1986?

Answer: The required quantity of commodities was made available by the Commodity Credit Corporation for programming in fiscal year 1986. Of this amount, we signed agreements for 336,000 metric tons of agricultural commodities with a CCC value of about $290 million.

Question: Do you expect they will be met in fiscal year 1987 and fiscal year 1988?

Answer: In fiscal year 1987, the minimum commodity levels were made available. We expect to donate the full amount made available in fiscal year 1987. To the extent that CCC has uncommitted inventory, particularly dairy stocks which have been declining, similar commodity amounts will be made available for donation in fiscal year 1988. Although difficult to forecast, we expect the commodities made available will be donated in fiscal year 1988.

SECTION 416 TONNAGE REQUIREMENTS

Question: If Section 416 tonnage requirements were set in order to supplement the quantities required under P.L. 480, why is the Administration using this program as a rationale for reducing P.L. 480 tonnage levels?

Answer: In fiscal year 1988, the estimated tonnage level under P.L. 480 is 7.8 million metric tons. This level does represent a small reduction from the amount expected to be programed in 1987, but was based on assessments of recipient country needs and budgetary requirements. This tonnage is well in excess of the average annual volume of commodities made available through the program in the early 1980's, when programing averaged 6.0 million metric tons annually.

It remains the view of the Department that P.L. 480 is the appropriate tool for achieving longer term goals concerning market development, food assistance, and foreign policy considerations with Section 416 programing being a supplement to this effort.

DONATION TONNAGE REQUIREMENTS TO EGYPT

Question: What are your expectations for donation tonnage requirements to Egypt during the remainder of this fiscal year and in fiscal year 1988?

Answer: We estimate U.S. donation requirements at 16,000 metric tons in fiscal year 1987 and about 8,000 metric tons in fiscal year 1988.

Question: When did you most recently update this information--i.e, does it include this year's crop predictions?

Answer: These estimates are current given the available information. The Nile River remains below desirable levels due to several years of poor rains in the Nile River Valley which extends through Egypt and Sudan. At the present time, no production shortfalls are forecast for Egypt.

P.L. 480 FOOD AID RECIPIENTS

Question: Would you please provide the committee with an updated situation report of P.L. 480 food aid recipients.

Answer: I will be more than happy to provide you with this information.

(The information follows)

December 31, 1986

Revised FY 1987 Public Law 480 Titles I/III
Country and Commodity Allocations

Country	$Mil. Total	Undesig-nated	Wheat/ Flour	Rice	Feed Grains	Vegoil	Total Food	Tallow	Cotton
		($Mil.)	(---1,000 Metric tons(grain equivalent)/1,000						bales)
$790 or Less Per Capita GNP									
Bangladesh	52.0	-	268	22	-	26	316	-	42
Bolivia	20.0	-	180	-	-	-	180	-	-
Egypt a/	185.0	-	1,488 b/	-	-	-	1,488	-	-
El Salvador	42.0	9.0	100	-	31	24	155	26	-
Ghana	8.0	-	-	20	-	-	20	-	20
Guinea	8.0	-	-	47	-	-	47	-	-
Guyana c/	5.0	-	45	-	-	-	45	-	-
Haiti	18.0	-	139	-	-	8	147	-	-
Honduras	12.0	-	80	-	-	10	90	6	-
Indonesia d/	15.0	-	137	-	-	-	137	-	-
Kenya	8.0	-	74	-	-	-	74	-	-
Liberia	10.0	-	-	55	-	-	55	-	-
Madagascar	8.0	2.0	40	-	-	3	43	-	-
Morocco	40.0	-	139	-	52	54	245	-	-
Pakistan	50.0	-	-	-	-	128	128	-	-
Senegal	5.0	-	-	28	-	-	28	-	-
Sierra Leone	4.0	-	18	11	-	-	29	-	-
Somalia	10.0	-	-	-	-	16	16	-	4
Sri Lanka	15.5	-	138	-	-	-	138	-	-
Sudan	50.0	-	441 b/	-	-	-	441	-	-
Yemen	10.0	-	45	28	-	-	73	-	-
Zaire	14.0	-	50	30	-	-	80	-	15
Zambia	10.0	2.0	37	-	-	10	47	-	-
Subtotal	599.5	13.0	3,419	241	83	279	4,022 (80%)	32	81

Country	$Mil. Total	Undesig-nated	Wheat/ Flour	Rice	Feed Grains	Vegoil	Total Food	Tallow	Cotton
		($Mil.)	(---1,000 Metric tons(grain equivalent)/1,000 bales)						
Over $790 Per Capita GNP									
Costa Rica	16.0	-	129	-	-	-	129	-	-
Dominican Republic e/	30.0	-	119	55	-	19	193	-	-
Guatemala f/	19.0	-	118	-	11	10	139	-	-
Jamaica g/	38.4	-	170 b/	42	105	-	317	-	-
Peru	20.0	-	117	38	-	-	155	-	-
Tunisia	10.0	-	92	-	-	-	92	-	-
Subtotal	133.4	-	745	135	116	29	1,025 (20%)	-	-
Allocated	732.9	13.0	4,164	376	199	308	5,047	32	81
Unallocated Reserve	100.0	-	-	-	-	-	-	-	-
Ocean Freight Financing	8.7 h/								
Total Commodity Program Plus Ocean Freight Financing	841.6	-	-	-	-	-	-	-	-

a/ Program carry-in of $15.9 million.
b/ Wheat equivalent of flour or contains some portion of wheat equivalent of flour.
c/ Program carry-in of $600,000.
d/ Program carry-in of $6.5 million.
e/ Program carry-in of $17.1 million.
f/ Program carry-in of $1.0 million.
g/ Program carry-in of $2.4 million.
h/ Ocean freight financing for Somalia ($1 million) and Sudan ($7.7 million).

FY 87
P.L. 480 TITLE II
COUNTRY ALLOCATIONS
March 31, 1987

Region/Country	$000 Total	MTN Total
NEAR EAST - TOTAL	11,188.9	49,311.4
Egypt	4,213.2	15,693.5
Gaza	525.0	2,624.8
Morocco	5,428.8	26,029.2
West Bank	1,021.9	4,961.9
LATIN AMERICA - TOTAL	65,066.3	350,247.0
Bolivia	11,688.5	58,229.6
Costa Rica	212.6	919.4
Dominican Rep.	1,829.7	9,986.9
Ecuador	4,354.8	14,139.1
El Salvador	6,796.5	36,663.0
Guatemala	9,235.9	48,843.7
Guyana	46.6	199.1
Haiti	13,890.6	91,774.5
Honduras	4,608.2	23,859.3
Jamaica	1,619.4	10,650.0
Mexico	2,277.3	10,246.3
Panama	60.1	314.8
Paraguay	217.2	975.2
Peru	8,222.6	43,411.1
St. Kitts	1.8	10.0
St. Lucia	4.5	25.0
ASIA - TOTAL	145,973.8	750,563.7
Bangladesh	20,104.8	173,374.8
Bhutan	753.6	2,864.0
India	86,318.5	311,434.3
Indonesia	4,356.5	25,911.7
Kampuchea	525.7	800.1
Nepal	1,772.9	7,199.9
Pakistan	17,864.9	139,942.8
Philippines	11,486.4	66,912.4
Solomon Islands	0.0	0.0
Sri Lanka	2,790.5	22,123.7
EUROPE - TOTAL	2,192.3	4,943.3
Poland	2,192.3	4,943.3

Region/Country	$000 Total	MTN Total
AFRICA - TOTAL	125,441.6	639,021.0
Angola	3,419.9	12,410.0
Benin	1,546.5	8,547.6
Botswana	7,548.6	46,481.8
Burkina Faso	5,997.9	28,146.6
Burundi	171.6	809.7
Cameroon	590.2	2,395.0
Cape Verde	1,986.4	17,290.7
C.A.R.	536.2	2,600.0
Chad	2,834.6	18,364.8
Comoro Is.	727.1	4,154.5
Congo	120.4	509.9
Eq. Guinea	367.9	1,700.1
Ethiopia	4,423.7	19,370.0
Ethiopia Refugee	804.2	5,899.9
Gambia	2,611.2	13,650.1
Ghana	9,779.7	41,995.3
Guinea	202.9	1,312.7
Guinea Bissau	875.7	3,553.0
Ivory Coast	212.1	988.8
Kenya	1,629.1	6,373.0
Lesotho	6,646.3	30,157.4
Liberia	160.0	779.8
Madagascar	1,475.3	7,048.0
Malawi	423.9	1,700.1
Mali	4,458.8	22,505.7
Mauritania	3,546.0	27,749.3
Mauritius	374.2	1,999.9
Mozambique	20,987.9	99,371.8
Niger	1,295.0	6,412.5
Rwanda	3,544.4	16,481.0
Sao Tome	525.4	2,253.5
Senegal	3,581.5	22,920.3
Seychelles	116.9	571.5
Sierra Leone	1,051.8	3,845.2
Somalia	6,260.2	38,666.8
Sudan	1,868.7	7,983.4
Swaziland	273.5	597.4
Tanzania	5,207.7	27,715.7
Togo	2,487.8	13,287.7
Uganda	8,054.3	23,579.4
Zaire	6,630.3	46,441.5
Zambia	85.8	399.6
Total World	349,862.9	1,794,086.4

Region/Country	$000 Total	MTN Total
Near East	11,188.9	49,311.4
Regular	10,968.4	47,311.5
Emergency	220.5	1,999.9
Latin America	65,066.3	350,247.0
Regular	50,407.8	256,138.7
Emergency	14,658.5	94,108.3
Africa	125,441.6	639,021.0
Regular	82,337.0	442,008.4
Emergency	43,104.6	197,012.6
Asia	145,973.8	750,563.7
Regular	133,619.6	652,761.3
Emergency	12,354.2	97,802.4
Europe	2,192.3	4,943.3
Regular	0.0	0.0
Emergency	2,192.3	4,943.3
Subtotal - Regions	349,862.9	1,794,086.4
Regular	277,332.8	1,398,219.9
Emergency	72,530.1	395,866.5
Reserve	102,841.5	333,300.0
Stock adjustment (-)	(40,594.4)	(188,027.9)
Transport Costs	121,500.0	
Farmer to Farmer	534.0	
TOTAL PROGRAM LEVEL	534,144.0	1,939,358.5

FY 87
P.L. 480 TITLE II
COUNTRY ALLOCATIONS
March 31, 1987

	$000	MTN	$000				MTN			
Region/Country	Total	Total	Total	Volags	WFP	GTG	Total	Volags	WFP	GTG
NEAR EAST - TOTAL	11,188.9	49,311.4	11,188.9	9,818.8	1,149.6	220.5	49,311.4	40,626.4	6,685.1	1,999.9
Egypt	4,213.2	15,693.5	4,213.2	3,992.7	---	220.5	15,693.5	13,693.6	---	1,999.9
Gaza	525.0	2,626.8	525.0	525.0	---	---	2,626.8	2,626.8	---	---
Morocco	5,428.8	26,029.2	5,428.8	4,279.2	1,149.6	---	26,029.2	19,344.1	6,685.1	---
West Bank	1,021.9	4,961.9	1,021.9	1,021.9	---	---	4,961.9	4,961.9	---	---
LATIN AMERICA - TOTAL	65,066.3	350,247.0	65,066.3	34,762.2	18,262.9	12,041.2	350,247.0	177,936.2	95,203.7	77,107.1
Bolivia	11,688.5	58,229.6	11,688.5	10,016.7	1,228.2	443.6	58,229.6	51,340.8	4,968.3	1,920.5
Costa Rica	212.6	919.4	212.6	---	212.6	---	919.4	---	919.4	---
Dominican Rep.	1,829.7	9,986.9	1,829.7	1,647.7	182.0	---	9,986.9	9,187.2	799.7	---
Ecuador	4,354.8	14,139.1	4,354.8	456.1	572.8	3,325.9	14,139.1	1,639.3	2,199.9	10,299.9
El Salvador	6,796.5	36,663.0	6,796.5	1,439.4	4,388.5	968.6	36,663.0	7,193.6	24,846.3	4,623.1
Guatemala	9,235.9	48,843.7	9,235.9	4,299.5	4,936.4	---	48,843.7	22,119.2	26,724.5	---
Guyana	46.6	199.1	46.6	---	46.6	---	199.1	---	199.1	---
Haiti	13,890.6	91,774.5	13,890.6	6,308.6	1,289.5	6,292.5	91,774.5	31,733.2	5,777.9	54,263.4
Honduras	4,608.2	23,859.3	4,608.2	3,261.9	1,346.3	---	23,859.3	14,592.2	9,267.1	---
Jamaica	1,619.4	10,650.0	1,619.4	314.2	294.6	1,010.6	10,650.0	2,850.0	1,799.8	6,000.2
Mexico	2,277.3	10,246.3	2,277.3	---	2,277.3	---	10,246.3	---	10,246.3	---
Panama	60.1	314.8	60.1	---	60.1	---	314.8	---	314.8	---
Paraguay	217.2	975.2	217.2	---	217.2	---	975.2	---	975.2	---
Peru	8,222.6	43,411.1	8,222.6	7,018.1	1,204.5	---	43,411.1	37,280.7	6,130.4	---
St. Kitts	1.8	10.0	1.8	---	1.8	---	10.0	---	10.0	---
St. Lucia	4.5	25.0	4.5	---	4.5	---	25.0	---	25.0	---
ASIA - TOTAL	145,973.8	750,563.7	145,973.8	105,777.8	37,528.9	2,667.1	750,563.7	498,720.8	228,842.8	23,000.1
Bangladesh	20,104.8	173,374.8	20,104.8	13,915.4	6,189.4	---	173,374.8	120,000.0	53,374.8	---
Bhutan	753.6	2,864.0	753.6	---	753.6	---	2,864.0	---	2,864.0	---
India	86,318.5	311,434.3	86,318.5	75,498.8	10,819.7	---	311,434.3	280,734.4	30,699.9	---
Indonesia	4,356.5	25,911.7	4,356.5	3,866.7	489.8	---	25,911.7	24,186.2	1,725.5	---
Kampuchea	525.7	800.1	525.7	---	525.7	---	800.1	---	800.1	---
Nepal	1,772.9	7,199.9	1,772.9	---	1,772.9	---	7,199.9	---	7,199.9	---
Pakistan	17,864.9	139,942.8	17,864.9	---	15,197.8	2,667.1	139,942.8	---	116,942.7	23,000.1
Philippines	11,486.4	66,912.4	11,486.4	11,445.8	40.6	---	66,912.4	66,676.5	235.9	---
Solomon Islands	0.0	0.0	0.0	---	---	---	0.0	---	---	---
Sri Lanka	2,790.5	22,123.7	2,790.5	1,051.1	1,739.4	---	22,123.7	7,123.7	15,000.0	---
EUROPE - TOTAL	2,192.3	4,943.3	2,192.3	2,192.3	0.0	0.0	4,943.3	4,943.3	0.0	0.0
Poland	2,192.3	4,943.3	2,192.3	2,192.3	---	---	4,943.3	4,943.3	---	---
AFRICA - TOTAL	125,441.6	639,021.0	125,441.6	41,833.7	34,763.6	48,844.3	639,021.0	194,114.3	183,733.1	261,173.6
Angola	3,419.9	12,410.0	3,419.9	---	---	3,419.9	12,410.0	---	---	12,410.0
Benin	1,546.5	8,547.6	1,546.5	1,099.0	447.5	---	8,547.6	5,767.9	2,779.7	---
Botswana	7,548.6	46,481.8	7,548.6	---	4,136.3	3,412.3	46,481.8	---	26,041.4	20,440.4
Burkina Faso	5,997.9	28,146.6	5,997.9	5,077.8	920.1	---	28,146.6	24,427.6	3,719.0	---
Burundi	171.6	809.7	171.6	---	171.6	---	809.7	---	809.7	---
Cameroon	590.2	2,395.0	590.2	---	590.2	---	2,395.0	---	2,395.0	---
Cape Verde	1,986.4	17,290.7	1,986.4	---	587.3	1,399.1	17,290.7	---	4,199.4	13,091.3
C.A.R.	536.2	2,600.0	536.2	---	536.2	---	2,600.0	---	2,600.0	---
Chad	2,834.6	18,364.8	2,834.6	1,266.0	1,568.6	---	18,364.8	11,407.1	6,957.7	---
Comoro Is.	727.1	4,154.5	727.1	---	727.1	---	4,154.5	---	4,154.5	---
Congo	120.4	509.9	120.4	---	120.4	---	509.9	---	509.9	---
Eq. Guinea	367.9	1,700.1	367.9	---	367.9	---	1,700.1	---	1,700.1	---
Ethiopia	4,423.7	19,370.0	4,423.7	4,423.7	---	---	19,370.0	19,370.0	---	---
Ethiopia Refugee	804.2	5,899.9	804.2	804.2	---	---	5,899.9	5,899.9	---	---
Gambia	2,611.2	13,650.1	2,611.2	624.8	280.7	1,705.7	13,650.1	2,546.0	1,633.9	9,470.2
Ghana	9,779.7	41,995.3	9,779.7	5,732.8	4,046.9	---	41,995.3	23,259.5	18,735.8	---
Guinea	202.9	1,312.7	202.9	---	202.9	---	1,312.7	---	1,312.7	---
Guinea Bissau	875.7	3,553.0	875.7	---	875.7	---	3,553.0	---	3,553.0	---
Ivory Coast	212.1	988.8	212.1	---	212.1	---	988.8	---	988.8	---
Kenya	1,629.1	6,373.0	1,629.1	1,563.5	65.6	---	6,373.0	6,273.2	99.8	---
Lesotho	6,646.3	30,157.4	6,646.3	3,151.5	3,494.8	---	30,157.4	14,326.9	15,830.5	---
Liberia	160.0	779.8	160.0	---	160.0	---	779.8	---	779.8	---
Madagascar	1,475.3	7,048.0	1,475.3	1,475.3	---	---	7,048.0	7,048.0	---	---
Malawi	423.9	1,700.1	423.9	---	423.9	---	1,700.1	---	1,700.1	---
Mali	4,458.8	22,505.7	4,458.8	233.8	2,423.8	1,801.2	22,505.7	1,646.6	10,859.1	10,000.0
Mauritania	3,546.0	27,749.3	3,546.0	953.0	624.3	1,968.7	27,749.3	4,158.6	3,590.7	20,000.0

Region/Country	$000	MTN	$000				MTN			
	Total		Total	Volags	WFP	GTG	Total	Volags	WFP	GTG
Mauritius	374.2	1,999.9	374.2	---	374.2	---	1,999.9	---	1,999.9	---
Mozambique	20,987.9	99,371.8	20,987.9	4,000.2	---	16,987.7	99,371.8	15,000.0	---	84,371.8
Niger	1,295.0	6,412.5	1,295.0	---	1,295.0	---	6,412.5	---	6,412.5	---
Rwanda	3,544.4	16,481.0	3,544.4	3,201.3	343.1	---	16,481.0	15,523.5	957.5	---
Sao Tome	525.4	2,253.5	525.4	---	525.4	---	2,253.5	---	2,253.5	---
Senegal	3,581.5	22,920.3	3,581.5	2,788.6	792.9	---	22,920.3	16,269.2	6,651.1	---
Seychelles	116.9	571.5	116.9	116.9	---	---	571.5	571.5	---	---
Sierra Leone	1,051.8	3,845.2	1,051.8	979.7	72.1	---	3,845.2	3,445.1	400.1	---
Somalia	6,260.2	38,666.8	6,260.2	---	6,260.2	---	38,666.8	---	38,666.8	---
Sudan	1,868.7	7,983.4	1,868.7	1,187.6	427.1	254.0	7,983.4	3,168.4	2,625.0	2,190.0
Swaziland	273.5	597.4	273.5	---	273.5	---	597.4	---	597.4	---
Tanzania	5,207.7	27,715.7	5,207.7	814.1	94.6	4,299.0	27,715.7	2,416.3	299.4	25,000.0
Togo	2,487.8	13,287.7	2,487.8	1,983.3	504.5	---	13,287.7	9,647.6	3,640.1	---
Uganda	8,054.3	23,579.4	8,054.3	227.6	731.3	7,095.4	23,579.4	499.9	3,879.6	19,199.9
Zaire	6,630.3	46,441.5	6,630.3	129.0	---	6,501.3	46,441.5	1,441.5	---	45,000.0
Zambia	85.8	399.6	85.8	---	85.8	---	399.6	---	399.6	---
Total World	349,862.9	1,794,086.4	349,862.9	194,384.8	91,705.0	63,773.1	1,794,086.4	916,341.0	514,464.7	363,280.7
Near East	11,188.9	49,311.4	11,188.9	9,818.8	1,149.6	220.5	49,311.4	40,626.4	6,685.1	1,999.9
Regular	10,968.4	47,311.5	10,968.4	9,818.8	1,149.6	0.0	47,311.5	40,626.4	6,685.1	0.0
Emergency	220.5	1,999.9	220.5	0.0	0.0	220.5	1,999.9	0.0	0.0	1,999.9
Latin America	65,066.3	350,247.0	65,066.3	34,762.2	18,262.9	12,041.2	350,247.0	177,936.2	95,203.7	77,107.1
Regular	50,407.8	256,138.7	50,407.8	34,374.5	14,380.7	1,652.6	256,138.7	176,003.9	70,414.2	9,720.6
Emergency	14,658.5	94,108.3	14,658.5	387.7	3,882.2	10,388.6	94,108.3	1,932.3	24,789.5	67,386.5
Africa	125,441.6	639,021.0	125,441.6	41,833.7	34,763.6	48,844.3	639,021.0	194,114.3	183,733.1	261,173.6
Regular	82,337.0	442,008.4	82,337.0	34,426.2	30,235.8	17,675.0	442,008.4	163,714.3	155,732.6	122,561.5
Emergency	43,104.6	197,012.6	43,104.6	7,407.5	4,527.8	31,169.3	197,012.6	30,400.0	28,000.5	138,612.1
Asia	145,973.8	750,563.7	145,973.8	105,777.8	37,528.9	2,667.1	750,563.7	498,720.8	228,842.8	23,000.1
Regular	133,619.6	652,761.3	133,619.6	104,385.8	29,233.8	0.0	652,761.3	491,718.6	161,042.7	0.0
Emergency	12,354.2	97,802.4	12,354.2	1,392.0	8,295.1	2,667.1	97,802.4	7,002.2	67,800.1	23,000.1
Europe	2,192.3	4,943.3	2,192.3	2,192.3	0.0	0.0	4,943.3	4,943.3	0.0	0.0
Regular	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Emergency	2,192.3	4,943.3	2,192.3	2,192.3	0.0	0.0	4,943.3	4,943.3	0.0	0.0
Subtotal - Regions	349,862.9	1,794,086.4	349,862.9	194,384.8	91,705.0	63,773.1	1,794,086.4	916,341.0	514,464.7	363,280.7
Regular	277,332.8	1,398,219.9	277,332.8	183,005.3	74,999.9	19,327.6	1,398,219.9	872,063.2	393,874.6	132,282.1
Emergency	72,530.1	395,866.5	72,530.1	11,379.5	16,705.1	44,445.5	395,866.5	44,277.8	120,590.1	230,998.6
Reserve	102,841.5	333,300.0								
Stock adjustment (-)	(40,594.4)	(188,027.9)								
Transport Costs	121,500.0									
Farmer to Farmer	534.0									
TOTAL PROGRAM LEVEL	534,144.0	1,939,358.5								

Question: Also, please comment on any absorptive capacity obstacles that are being encountered.

Answer: We frequently encounter situations that limit the absorptive capacities of P.L. 480 recipients. For example, in many African countries, port conditions may restrict the size of vessels that can enter, and discharge rates are often low because of inadequate or archaic equipment. In addition, port and inland storage facilities are limited and easily overloaded. We must also take care to insure that P.L. 480 shipments do not compete with domestic production for limited storage space. Inadequate rail and truck services also prevent commodities from being distributed quickly and efficiently.

P.L. 480 SHIPMENTS TO SUDAN

Question: Is transportation for the Sudan region still inhibited, and must P.L. 480 shipments be routed through Western Africa?

Answer: Transportation within Sudan remains difficult and is especially inhibited in the southern region by insurgency. P.L. 480 commodities are not being routed through Western Africa, nor would that be practical. However, Uganda has served as a transport point into southern Sudan, and Kenya is cooperating in a swap arrangement to provide corn to Sudan in exchange for Title II wheat. Title I wheat and wheat flour is scheduled to arrive in Port Sudan over the next few months.

Question: Is this situation improving?

Answer: Increased insurgency in Uganda and impending rains will exacerbate the transportation situation in the south of Sudan. International donors are considering an airlift to get food supplies to the southern areas most isolated by the insurgency.

FARM BILL REQUIREMENTS

Question: Has the 1985 Farm Bill requirement for fortified or processed food under Title II been implemented?

Answer: The Food Security Act of 1985 requires that at least 75 percent of the quantity of non-emergency food aid under Title II be programmed as processed, fortified, bagged commodities.

To date, we are in compliance with this mandate. The processed, fortified, bagged percentage is over 77 percent.

Question: Have there been any difficulties in meeting the requirements of this legislation?

Answer: No significant difficulties have been experienced in meeting the requirements of this legislation. Although some adjustment in program levels were made--more bulk commodities under Section 416-- we have been able to manage without negative impacts.

TARGETED EXPORT ASSISTANCE

Section 1124 of the Food Security Act directed USDA to provide export assistance to counter the effects of unfair foreign trade practices through CCC commodity certificates. The Targeted Export Assistance program enables nonprofit agricultural associations and regional or state export promotion organizations to conduct specific foreign market development projects for eligible commodities.

The authorization for each fiscal year 1986 through 1988 was set at $110 million, and for each fiscal year 1989 through 1990 at $325 million.

Question: Please describe for the committee the range of commodities exported under the 43 TEA agreements signed in fiscal year 1986.

Answer: For the record, Section 1124 of the Food Security Act directs USDA to use at least $110 million for each fiscal year 1986 through 1988, and for each fiscal year 1989 through 1990 to use at least $325 million. We signed 42 TEA agreements in fiscal year 1986 with 38 separate participants representing virtually every major agricultural sector. These include feed grains, dry peas and lentils, wheat, wood products, poultry and eggs, meats, cling peaches, potatoes, walnuts, raisins, wine, prunes, citrus, apples, pears, grapes, almonds, pistachios, cotton, peanuts, soybeans and their products, pasta, and chocolate and confectionary products. As well, our four regional state groups participants are promoting a wide variety of high value products produced in the states that these organizations represent.

COMMODITIES EXPORTED UNDER TEA

Question: What is the estimated value of commodities exported under this program in fiscal year 1986? In fiscal year 1987?

Answer: The TEA program operates to counter or offset the negative effects on the exports of our agricultural commodities by providing CCC resources to participants to conduct export promotion program in foreign countries. The TEA program is not being used to buy down or otherwise directly offset the costs of U.S. exports as is the case with some other FAS programs such as the Export Enhancement and CCC credit programs. Although the TEA program is just a year old and it is difficult to determine a direct cause and effect relationship between export levels, we have to some extent been able to draw a measure of association between TEA assistance and increased exports of U.S. horticultural products. In all cases, we experienced significant export gains in TEA target markets over non-TEA markets. In dollar terms, TEA activities in targeted markets increased by $108 million during the 1986-1987 marketing year through January, 1987, compared to increases of about $47 million in non-TEA markets. Other competitive factors, such as the value of the dollar also play major roles in our ability to export.

NUMBER AND VALUE OF SIGNED TEA AGREEMENTS

Question: How many agreements and in what amount have been signed in fiscal year 1987?

Answer: To date we have committed a total of just over $34 million in fiscal year 1987 TEA resources among 12 participants. The major portion of the fiscal year 1987 TEA authorization will be committed later this month in a single allocation process.

Question: Will FAS provide the full support level of $110 million in fiscal year 1987 for TEA?

Answer: Yes, FAS will provide the full $110 million authorized for the TEA program in fiscal year 1987.

TEA FUNDING LEVEL REDUCTION

The Administration proposes to trim back TEA to $80 million in fiscal year 1988.

Question: Has legislation been sent to the House to effectuate this change in law?

Answer: Yes, the proposed legislation was forwarded to the House and Senate on March 3, 1987.

Question: When will it be introduced?

Answer: We are unsure at this time as to when the proposed legislation will be introduced.

Question: How does the Administration reconcile this cutback in TEA support with its overall goal for gaining access to unpenetrated foreign markets and for enhancing U.S. export activity?

Answer: The Department's proposal to reduce the funding level of the TEA program in fiscal year 1988 and in each fiscal year beyond by $30 million supports the President's deficit reduction efforts while maintaining a program level sufficient to satisfy the intent of the TEA legislation.

Question: If TEA is scaled back to $80 million in fiscal year 1988, won't the effect of this cutback have a severe impact on export enhancement efforts in light of the decline of the dollar in the world market?

Answer: We doubt that a cut back to $80 million in fiscal year 1988 will negatively impact our market development efforts. The fact that the value of the dollar is declining is really great news for agricultural exports. A cheaper dollar helps make our products more competitive. Additionally, and assuming the proposed cut back is passed as submitted, fiscal year 1989 will provide for three times the level of TEA resources over fiscal year 1988 resources.

Question: Is the Administration's proposal to cut back TEA funding in fiscal year 1988 the beginning of a trend for phasing down funding for this program over the next few years? Over the long-term?

Answer: The Administration proposal to cut back TEA funding is to support the President's budget deficit reduction efforts while continuing to maintain a program that meets the intent of the legislation. We can do both. As to a trend for a phase-down for the TEA program over the next few years--the TEA program will cease at the end of fiscal year 1990 as stated in the legislation. We have no authority to continue the program beyond fiscal year 1990. The TEA program is a short-term program, unlike our Foreign Market Development--or Cooperator--Program.

TEA VERSUS COOPERATOR PROGRAMS

Question: How does TEA work in conjunction with the cooperator development program?

Answer: The TEA program is a welcome complement to the Cooperator program. The TEA program permits short-term capital intensive campaigns not possible with the limited Cooperator program resources. The TEA program has also been the financial incentive for new organizations to work with FAS on export market development. These include the Walnut Marketing Board, the Kiwifruit Commission, the National Pasta Association and Chocolate Manufacturers Association. TEA program participation is limited to those commodities which can identify an unfair foreign trade practice which has adversely affected its exports.

NEW AREAS FOR TEA PROGRAM

Question: What new areas will be selected for TEA participation and for what commodities in the next fiscal year?

Answer: In accordance with the legislation, we will give priority funding to those commodities that have received a favorable Section 301 decision, or have suffered from retaliation as a result of a 301 decision. We have received proposals from every sector of U.S. agriculture. Although we have not yet finalized the allocation of fiscal year 1987 TEA resources, it is our intention to provide TEA assistance to groups that have been able to satisfactorily document the adverse effect of an unfair foreign trade practice will likely receive TEA assistance.

GREAT LAKES COMMODITY PRICES

Question: Are Great Lakes commodity prices competitive?

Answer: Since a number of commodity suppliers are located in the Midwest, commodity prices for delivery to Great Lakes ports are competitive when foreign flag steamship service is utilized.

SHIPMENTS OF P.L. 480 AT GREAT LAKES PORTS

Question: Has the level of P.L. 480 shipments at Great Lakes ports dropped off since the 1985 Farm Bill was enacted?

Answer: In 1986, about 225,000 metric tons of P.L. 480, Title II commodities and over 10,000 metric tons of Section 416 commodities were shipped through the Great Lakes. This slight decline in tonnage from 1985 TO 1986 is due to a smaller P.L. 480, Title II program level in 1986.

Question: What ports are picking up P.L. 480 shipments?

Answer: So far this year, the Great Lakes ports of Green Bay, Kenosha, and Milwaukee, Wisconsin have been allocated P.L. 480 cargo.

Question: Taking into consideration the shortage of American ships that are suitable for travel on the Great Lakes and their inability to use the locks, could you propose an initiative that would assure that the Great Lakes region could attain the set-aside levels established in law without inhibiting the implementation of cargo preference standards?

Answer: The Department is hopeful that newly implemented procurement regulations will allow us to meet both cargo preference requirements and Great Lakes tonnage requirements without detriment to any port range.

Question: Would seasonal or monthly quotas offer a viable alternative for meeting both the set-aside and cargo preference requirements?

Answer: The use of seasonal or monthly quotas may be a viable alternative, although it would appear to limit needed flexibility that annual requirements allow. We would, however, need to explore this further.

BLENDED CREDIT

Question: Have there been any initiatives to use blended credit during fiscal year 1986 and 1987? If not, why?

Answer: The Blended Credit Program has remained suspended since February 1985, when there was a court ruling that the program was subject to cargo preference legislation. Changes brought about by the Food Security Act of 1985 along with declining market interest rates have eliminated the need for the Blended Credit Program as previously constituted. The reduction in commodity price support loan rates which contributed to lower market prices and the Export Enhancement Program provided the means for becoming price competitive in targeted marketing. Due to current market conditions foreign customers are buying more on the basis of market price, with credit guarantees providing the margin of difference for some countries.

BARTER TRANSACTIONS

Question: What is the current status of the pilot barter program for exchange of agricultural commodities for strategic materials mandated under Section 1129 of the Food Security Act?

Answer: We are confident the Congress intended that we carry out this mandate in the most efficient and effective manner possible and to assure that any transaction carried out meets the intent and criteria called for by law. The Department is currently in the process of identifying countries that meet the criteria of Section 1129; the agricultural commodities that could be used in the exchange; and the strategic or other materials that could be furnished by those countries for which U.S. stockpile goals are unmet. Following the identification of countries, materials and the agricultural commodity that could be exchanged without displacement of commercial transactions, the proposals will be ranked as to their potential. Contact will then be made with the selected countries to determine their interest in carrying out a barter arrangement.

Question: How many barter transactions has FAS entered into for export sales of agricultural products during fiscal year 1986 and 1987?

Answer: We did not enter into any barter transaction in fiscal year 1986 and to date we have not concluded an arrangement for fiscal year 1987.

Question: Do you plan to enter into any barter transactions during fiscal year 1988?

Answer: We plan to carry out the mandate in Section 1129 and it could be possible to complete the two required pilot barter arrangements in fiscal year 1987. If we are successful, we have no plans at present to carry out barter transactions during fiscal year 1988.

Question: What are the advantages and disadvantages of barter transactions?

Answer: There are several advantages of barter transactions. For example barter could encourage exports of agricultural commodities to countries that are unable to purchase commodities for cash or on credit. Barter could marginally reduce the inventory of CCC resulting in reduced storage charges, or improve the defense posture of the U.S. by reducing stockpile deficits of strategic or other materials. Also barter could be used as a means to further U.S. policy, such as the arrangements with Jamaica.

There are several disadvantages of barter transactions. For example, exports of agricultural commodities tied to stockpile procurement are contrary to fundamental concepts of maximum free trade. It is difficult, if not impossible, to establish "additionality" to assure that barter arrangements do not displace commercial sales. Unless funds in the National Defense Stockpile Transaction Fund, administered by the General Services Administration, are budgeted for reimbursement to CCC, the CCC would have to hold title to the materials thereby reducing the amount of funds CCC has available to carry out agricultural programs. It is difficult to show that a barter arrangement is more cost effective that an open market purchase of stockpile materials. Also, U.S. Government involvement in barter arrangements could encourage other countries to increase barter or countertrade thereby restricting competition.

Finally, barter arrangements are complex, difficult and time consuming to carry out, and only result in insignificant increased exports. USDA resources should be directed towards those export programs which provide the most benefits by increased exports.

Question: Couldn't the U.S. gain by resale of products obtained through barter?

Answer: This would depend on the market value of the materials at the time the materials were acquired and at the time of the proposed sale. The market price at the time of sale would have to be substantially high enough to offset the higher cost of transporting the material on U.S. flag vessels as required by the Cargo Preference Act. Procurement of strategic materials overseas is not affected by the cargo preference compromise of the Food Security Act. A foreign commodity exchanged in barter, must be shipped on 50 percent U.S. flag carriers. The U.S. commodity traded in barter, would not be subject to the U.S. carrier provisions if exchanged at equivalent values based on prevailing world market prices. However, if the U.S. commodity was exchanged at less than equivalent value, then the barter arrangement would be viewed as a concessional sale. Concessional sales are subject to the U.S. flag carrier requirements of the cargo preference compromise at the rate in effect, at the time of the sale, either 70 percent or 75 percent. This would depend on the market value of the materials at the time the materials were acquired and at the time of the proposed sale. The market price at the time of sale would have to be substantially higher to offset the higher cost of transporting fifty percent of the materials on U.S. flag vessels as required by the Cargo Preference Act.

FAS EXPORT ENHANCEMENT PROGRAM

Sales under the Export Enhancement Program represented close to three percent of the volume of total U.S. agricultural exports in fiscal year 1986.

Question: What is your expectation of sales volume under the Export Enhancement Program in fiscal year 1987? In fiscal year 1988?

Answer: Through fiscal year 1986 about 19 million tons of commodities were announced as available, 5 million tons of which were subsequently withdrawn, and roughly 8 million tons were sold.

Through March of fiscal year 1987, 8 million tons more have been announced, and about 7 million tons have been sold, as the pace of sales under EEP has picked up. It is reasonable to estimate, therefore, that a total of 10 to 15 million tons might be sold in each of fiscal year 1987 and fiscal year 1988. But this will depend on various events that are not easy to foresee, such as competitor actions, customer demand, and other factors.

Question: Do you expect to commit the $1.5 billion in commodities stipulated under current law during the three-year duration of the EEP? Will this amount be sufficient?

Answer: At the current rate of using CCC commodities, it appears that we will come close to utilizing the amount indicated. This will depend on uncontrollable factors, however, such as changes in customer demand, moves by competitor countries, and other variables. But best estimates indicate that we are on track to use the $1.5 billion, and this amount appears to be sufficient.

WHEAT SALES UNDER EXPORT ENHANCEMENT PROGRAM

Question: What portion of U.S. wheat sales are transacted through the EEP?

Answer: Through fiscal year 1986, sales of wheat and flour under EEP accounted for about one-fourth of total wheat exported.

Through January of fiscal year 1987, the EEP sales of total wheat and flour exports has been closer to one-third. These ratios are likely to continue. It should be noted that sales made and actual exports recorded are not strictly comparable, but serve as a rough indicator of probable coverage.

Question: Will wheat sales increase or remain the same under the EEP targeted markets during fiscal year 1987? During fiscal year 1988?

Answer: Our expectations are that total world wheat import demand will grow during this period. This should provide the opportunity for more U.S. wheat sales under the EEP and in total.

Question: What is your estimate of 1987 exports of wheat not targeted under the EEP in fiscal year 1987? In fiscal year 1988?

Answer: Total U.S. wheat exports for fiscal year 1987 are projected at over 28 million tons. So far during fiscal year 1987 sales of wheat under EEP have accounted for around a third of total wheat exports. USDA has not officially released an estimate of fiscal year 1988 wheat exports. Therefore, we are unable to provide a breakdown for EEP and non-EEP exports at this time.

WHEAT SALES TO THE SOVIET UNION

Question: Was the 1986 decline in Soviet purchases of U.S. wheat a repercussion of Soviet ineligibility for the EEP, or are there other factors, such as grain quality, that contributed to the decline?

Answer: The USSR has indicated that they would be interested in buying U.S. wheat if it were priced competitively. Their exclusion from EEP except for the August-September, 1986, period likely contributed to their lack of wheat purchases. Improved USSR wheat crops in 1985 and 1986 sharply reduced their import requirements from earlier levels. During the recent U.S.-USSR grain consultations, the Soviet side indicated that they consider that matters are now going reasonably well, insofar as quality is concerned.

Question: How did sales to the Soviet Union in 1986 compare to sales in 1984 and 1985?

Answer: Wheat sales to the USSR in fiscal year 1986 totaled less than 200,000 tons compared with 2.9 million tons in fiscal year 1985 and 7.6 million tons in fiscal year 1984.

Question: What are your projections for 1987, particularly since the Soviet Union was made eligible for 4 million metric tons of wheat under the EEP?

Answer: The EEP offer to the USSR expired on September 30, 1986, and has not been renewed. The USSR has purchased no U.S. wheat since October, 1985, and with an improved 1986 domestic wheat crop and large wheat purchases from our competitors, the outlook for U.S. sales is not bright.

Question: What is the U.S. doing to increase wheat sales to the

Soviet Union?

Answer: We are in continuing contact with the Moscow buying authority and remain hopeful that through one measure or another, the wheat business can be re-established. A renewal of EEP for the USSR is an option that has been under review from time to time, but it is not certain that this would lead to increased sales.

REGISTRATION FOR EEP

Question: How many exporters are currently registered under the Export Enhancement Program?

Answer: At the current time there are 85 exporters qualified under the Export Enhancement Program.

Question: What is the criteria for a U.S. farmer to obtain registration?

Answer: An individual, partnership, corporation, association or other legal entity is eligible to participate under the Export Enhancement Program if the following basic requirements are met. The exporter must furnish a name and address for service of legal process in the United States. The exporter must identify their form of doing business. If they are a corporation we must know where they are incorporated. If they are a foreign corporation, they must have an office in the United States. The exporter must show that they have experience either exporting or selling for export the commodity which they are applying for qualification for under the Export Enhancement Program. This experience must be within the preceding three calendar years. The exporter must demonstrate proof of financial responsibility by either submitting an audited financial statement that shows a positive net worth or by describing participation in U.S. Government programs or contracts during the three preceding calendar years. This must be done in such a way that the Commodity Credit Corporation may verify this participation.

In addition to the four requirements I just discussed, there is one more requirement for the exporter who wishes to qualify to export dairy cattle under the program. Dairy cattle exporters must show that they are bonded and registered with the Packers and Stockyards Administration.

Question: Does FAS have the discretion to help farmers who have the initiative to create a market for their products abroad but who do not have the export experience?

Answer: Potential exporters can receive help in export marketing endeavors through FAS's agricultural information marketing system. This program provides potential exporters with trade leads, computerized marketing services, a trade referral publication and other technical and marketing assistance designed to help the exporter looking for markets for any particular commodity.

Question: Are we losing some export opportunities because of restrictions placed on farmers under the Export Enhancement Program?

Answer: No, on the contrary we have been able to make sales in many markets that would have been closed to us because we can now compete with the European Economic Community and others who are subsidizing in the markets targeted by the Export Enhancement Program. We should also add that the farmer is also helped through the GSM-102 and GSM-103 credit guarantee programs which help promote the export of various commodities by offering the overseas buyer the opportunity to finance their purchases over a number of years.

FAS AGRICULTURAL TRADE OFFICES

The Agricultural Trade Act of 1978 called for the establishment of 25 Agricultural Trade Offices.

Question: Please tell the committee the location proposed for each of the remaining 10 offices were they to be established in the near future.

Answer: The Agricultural Trade Act of 1978 mandated the creation of at least 6 and not more than 25 Agricultural Trade Offices. FAS has established 15 so far. We are constantly reviewing opportunities for the placement of trade offices in countries showing the greatest export potential. However, recent budgetary constraints severely limit planning for additional staffing over the next two years.

Question: Are there any plans to open any other agricultural trade offices in the western hemisphere?

Answer: We are reviewing U.S. agricultural export potential in western hemisphere countries along with all other destinations but we have no plans to open any other Agricultural Trade Offices in the western hemisphere at this time.

Question: How would each of these offices improve and enhance U.S. Agricultural exports?

Answer: The function of an Agricultural Trade Office is to improve the servicing we offer to the private trade and to consolidate all agricultural market promotion activities into a one stop facility. Each new ATO implements these general goals in a manner consistent with the local market conditions and opportunities. There are no plans to open new offices at this time so there are no specific justifications in preparation. The two newest trade offices to be opened were in Tokyo, Japan and Istanbul, Turkey.

Japan continues to be our top export market. Despite recent declines in U.S. bulk product exports to Japan, long-term prospects are viewed favorably. This is especially true in the area of value-added and processed food products, whose trend has been steadily upward in recent years. The ATO in Japan is in a unique position to assist U.S. exporters in locating and maintaining these markets. Increased export promotion activity on the part of both FAS and the private sector, as well as a period of important bilateral trade negotiations, point to the need for increased coverage in this critical market.

Turkey, and to some degree Syria--both covered by ATO/Istanbul--represent markets with recently improved climates for agricultural trade. While Turkey has traditionally been the region's leading agricultural producer and exporter, it recently has stepped up its imports as a means of feeding its growing population and improving the efficiency of its domestic agriculture. We expect that by focusing resources now, we will be in a better position to improve U.S. export sales in that important part of the world.

Question: What would be the cost of starting up these offices?

Answer: The cost of each future ATO opening depends on the cost of office space in the city to be chosen, the facilities required in the office, and the number of staff to be accommodated in the office. These costs would be estimated when the possibility of opening a new ATO is under consideration.

FOREIGN POSTS

The Foreign Agricultural Service operates through 76 posts around the world.

Question: Please tell the committee whether these posts are collocated with other U.S. Government offices abroad and how their work benefits U.S. involvement in the world marketplace.

Answer: Most of our 76 posts abroad are collocated in the U.S. Embassy or Consulate with other U.S. Government agencies. An exception is the Trade Offices which are generally not collocated with other government offices.

The work of these 76 posts benefits U.S. involvement in the world marketplace by providing an information base which is essential to effective marketing. They also work on trade barriers which restrict U.S. sales, provide information on sales opportunities for U.S. exporters, encourage the effective use of credit and other export assistance programs, monitor and report on activities of our competitors and carry out a wide range of market promotion activities. The latter includes assisting cooperators with their marketing plans, arranging U.S. firms' participation in trade shows, setting up in-store promotions for U.S. products and other activities aimed at putting the U.S. seller in touch with buyers in their country of assignment.

Question: How would the establishment of more Agricultural Trade Offices complement the work of FAS in export promotion?

Answer: The ATO's have taken on a wide variety of responsibilities in FAS's overall program to increase exports of agricultural products. Their responsibilities depend on local opportunities. In all markets their functions are oriented toward the needs of private exporters. Should FAS be able to start up any more Agricultural Trade Offices, the specific benefits and opportunities of each location would be determined at that time.

FAS BUDGET FOR DOLLAR DEVALUATION

To maintain current FAS activities abroad, the fiscal year 1988 budget would require an increase of $1.6 million to offset losses in the overseas value of the dollar for Foreign Agricultural Affairs and

Foreign Market Development.

Question: Please explain how this figure was estimated.

Answer: First of all we would like to clear up some confusion surrounding the FAS fiscal year 1988 budget request. The amount requested will not permit us to maintain current FAS activities abroad. Although the budget does request $1.6 million in additional funding to offset losses in the overseas value of the dollar, it does not include funding to cover anticipated increases in overseas operating costs during fiscal year 1988 resulting from local wage and price increases, i.e., overseas inflation.

The amount requested for exchange rate losses was figured by comparing, on a country by country basis, current exchange rates with budgeted exchange rates. The budgeted exchange rates represent the rates used in calculating the original fiscal year 1987 budget request. In the case of the Japanese yen for example, the current exchange rate as of October 1, 1986 was 155 yen, to the dollar as compared to the budgeted rate of 253 to the dollar. To maintain FAS activities in Japan at current exchange rate levels would require a budget increase of 63 percent.

FAS STAFFING

Question: How many staff years did FAS employ during fiscal years 1977 through 1981 at the peak of agricultural export activity?

Answer: During this five year period FAS averaged approximately 887 staff years.

Question: How does this figure compare to the number of FAS employees today?

Answer: This compares to a current staff year estimate of 800 for both fiscal year 1987 and fiscal year 1988.

Question: What has been the impact of the new agricultural export initiatives set out in the Food Security Act in Sections 1121 and 1141 with respect to staffing and resources within FAS?

Answer: Title XI of the Food Security Act contains a dozen export initiatives that FAS and the Office of the General Sales Manager have responsibility for carrying out. To cope with the additional workload we have submitted a budget supplemental for fiscal year 1987 requesting an increase of $705,000 and 10 staff years. This amount is also included in the fiscal year 1988 budget request. The appropriation of these funds will help alleviate the additional workload pressure and also avoid the possibility of having to reduce important efforts in other areas such as providing support to the ongoing trade negotiation process.

Question: Are the goals set out in the Food Security Act achievable based on the fiscal year 1988 budget proposal?

Answer: We believe that the goals set out in the Food Security Act are achievable based on the fiscal year 1988 budget proposal. It is very likely, however, that some cutback in our overseas operations will be necessary to accommodate the reduced purchasing power of the dollar resulting from exchange rate fluctuation and overseas wage and price increases.

FOREIGN MARKET DEVELOPMENT COOPERATOR PROGRAM

Market development activities are encouraged through FAS support of Cooperator programs providing trade servicing, technical assistance, and consumer promotion through 59 Cooperator offices overseas.

Question: What is the level of funding that FAS is contributing to market development Cooperator programs in fiscal year 1987. How does this compare with the past five fiscal years?

Answer: In fiscal year 1987, FAS will contribute $30 million to the Cooperator program. FAS contributions over the previous five years were: fiscal year 1982, $24.9 million; fiscal year 1983, $28.1 million; fiscal year 1984, $31.3 million; fiscal year 1985, $33.7 million; and fiscal year 1986, $28.9 million.

Question: What are your expectations for fiscal year 1988.

Answer: We expect to maintain the same funding level of $30 million for the Cooperator program as in fiscal year 1987.

Question: What is the estimated investment of Cooperators in these market development programs?

Answer: The Cooperator program generates about two dollars worth of Cooperator contributions for every dollar of Government funds.

Question: Do Cooperators make cash or in-kind contributions to these programs?

Answer: Cooperators make both cash and in-kind contributions--what we refer to as goods and services--and also solicit contributions from foreign third parties with whom they work abroad to promote U.S. exports.

FAS EVALUATION OF COOPERATOR PROGRAM

Question: Has FAS evaluated the Cooperator programs to determine what type of market development activities are most effective versus those that should be discontinued?

Answer: Yes, FAS has a Strategic Planning Process whereby the Cooperators and FAS jointly review the effectiveness of market development activities that result in periodic fine tuning of market development strategies, including determinations as to which activities are not effective. Our Strategic Planning Process identifies on a macro scale which commodity/market combinations worldwide offer the greatest potential returns in exports for dollars invested in market promotion.

ESTIMATED LEVEL OF INCREASED EXPORT ACTIVITY

Question: Has FAS estimated the level of increased export activity that has resulted from market development programs.

Answer: Yes, FAS and Cooperators through the Strategic Planning Process, makes estimates on increased export activity resulting from market development programs. The last Strategic Planning exercise estimated the return in U.S. export gains attributable to market development at approximately 80 to 1.

COOPERATOR OFFICES OVERSEAS

Question: Do Cooperator offices overseas exist independent of other USDA posts or are functions coordinated with other posts or trade offices?

Answer: Cooperator offices overseas, per se, maintain their own identity and are independently managed and supervised by the Cooperator home office in the U.S. However, the location and functions of those offices are closely coordinated with those of FAS's own offices overseas. A factor in FAS's internal review of foreign posts is the current and projected level of cooperator activity and consequent impact on the level of FAS resources needed to coordinate those efforts. Where feasible and cost efficient, Cooperators have collocated their foreign offices with FAS's Agricultural Trade Offices--as in Hamburg, London, Singapore, Tokyo, Seoul, and Caracas. In other countries, cooperators are collocated with each other to minimize costs or facilitate coordination of programs. As is true with virtually every aspect of the program, decisions regarding the location and functions of Cooperator foreign offices are jointly negotiated and decided by FAS and Cooperators.

Question: Are there plans for expansion of the number of Cooperator offices overseas?

Answer: No, there are no plans to expand the number of Cooperator offices overseas.

ACTIVE MARKET DEVELOPMENT PROGRAMS

Question: What specific market development programs, such as the Export Incentive Program and the Value-Added Product Promotion Program are ongoing?

Answer: In fiscal year 1987, Export Incentive Programs for almonds and citrus are being funded through the Targeted Export Assistance program, and in addition to those, the Value-Added Product Promotion Program, conducted by the four regional state groups.

Question: Please provide the Committee with a listing of the various promotion projects and estimated expenditures by FAS in fiscal year 1987 and 1988.

Answer: Current fiscal year 1987 cooperator budget estimates will be provided for the record based on marketing plans approved to date. We expect fiscal year 1988 levels to be within the same range.

(The information follows)

Program Area	($ Thousands)
Dairy, Livestock and Poultry Products -- also includes leather, mink, aquaculture, and rendered products	$4,420
Forest Products	$1,963
Horticultural and Tropical Products -- also includes tree nuts and wine	$746
High Value Products	$597
Oilseeds and Products	$6,502
Tobacco, Cotton and Seeds	$1,416
Grain and Feed	$10,995
TOTAL	$26,639

COMMERCIAL EXPORT CREDIT PROGRAMS

The Food Security Act of 1985 made available $5 billion annually for short-term loan guarantees eligible countries for the purchase of eligible commodities.

In addition, the Act specified that $500 million would be made available for an Intermediate Credit Guarantee Program (GSM-103) to help developing nations make cash commodity purchases through three to ten-year loan agreements.

Question: I am aware that FAS screens these transactions carefully, yet, I am interested in learning whether there have been any defaults on GSM-102 or GSM-103 loans to date?

Answer: The Commodity Credit Corporation has paid claims for 13 countries that encompass the GSM-101 and GSM-102 programs. While we cannot separate the data for these two programs at this time we would expect that most of these claims relate to the GSM-102 program. No claims have been paid on GSM-103. However, we are confident that these claims will eventually be paid to the Federal Government through rescheduling agreements.

Question: Has the United States had to pay lending institutions as a result of a default?

Answer: Since 1981, CCC has made payments of approximately $2.2 billion due to both nonpayment of debt and official debt reschedulings. As I said before, we fully anticipate to recoup all of all of these expenditures through existing or prospective rescheduling agreements.

COMMERCIAL EXPORT CREDIT PROGRAMS

Question: How many refinancing arrangements have been required under these credit programs?

Answer: To date, 12 countries have rescheduled their GSM-102 debt. There has been no rescheduling of GSM-103, since it is a new program. The following countries have rescheduled CCC export credit guarantees.

GSM-102 COUNTRY RESCHEDULINGS

- Brazil
- Dominican Republic
- Mexico
- Panama
- Philippines
- Romania
- Chile
- Jamaica
- Morocco
- Peru
- Poland
- Sudan

Question: Are these programs working well?

Answer: These programs continue to serve as important market development instruments by providing credit to developing country purchasers. Sales registrations to date in fiscal year 1987 are approximately at the rate of fiscal year 1986 and fiscal year 1985, when the annual total was about $2.5 billion. This is somewhat less that the early 1980's due to several factors, including diminished buying capacity among developing countries, lower unit prices, and increased price competitiveness due to heavy world supplies of major bulk commodities. Credit can be the decisive factor in getting export sales only if prices are roughly equivalent; GSM-102 and GSM-103 will be successful in coming years to the extent that our commodity prices can meet the competition -- due either to our reduced price supports or to export programs such as the Export Enhancement Program.

Question: What is the level of U.S. agricultural exports that has been generated through these credit programs in fiscal year 1986 and 1987?

Answer: In fiscal year 1986, GSM-102 short-term credit guarantees totaling $4.2 billion were made available to 26 countries. Of the amount available, $2.5 billion were approved for use in which the exporter paid the origination fee. In fiscal year 1987, as of March 7, 1986, $3.8 million of short-term credit guarantees have been made available and $.9 million has been approved. By the end of this year, we expect the program participation to be somewhat higher than last year.

In fiscal year 1986, the GSM-103 intermediate credit guarantees were initiated. A total of $377 million of credit guarantees was made available and $13 million were approved. In fiscal year 1987, we expect greater use of this program. As of March 6, 1987, $330 million in intermediate credit guarantees were made available and $30 million have been approved.

COMMERCIAL EXPORT CREDIT PROGRAMS

Question: Please explain the Administration's proposal to increase the GSM-102 loan guarantee origination fee.

Answer: The proposed legislation submitted to the Congress concerning the GSM-102 credit guarantee fee or origination fee would provide the Administration more flexibility in setting the level of the fee. The proposal would delete the provision setting the maximum origination fee for GSM-102 at one percent.

Question: Would this proposal deter greater participation in the loan program?

Answer: Any increase in the origination fee would be largely passed on to the importing country. Therefore, we would expect that actions which increase the purchase price will tend to lower participation in the program.

Question: Is this fee paid before or after an export transaction is completed?

Answer: The fees for the GSM-102 and GSM-103 programs are paid at the time the export is registered for coverage and precedes actual exportation.

Question: Is this fee arrangement an impediment to U.S. sellers or to foreign importers?

Answer: Any fee charged which is largely passed on to the importer, as in the GSM-102 and GSM-103 programs, has the potential of lowering exports under the program. The current fee paid by exporters is a cost to them; however, it does help assure they are bonafide exporters. Depending upon market conditions part of the fee may be passed on to the buyer.

Question: How does it affect smaller transactions?

Answer: The fee does not differentiate between small versus large transactions because the fee is based on a percentage of the guaranteed value.

PLANNED LEGISLATION

The Administration plans to introduce legislation to reduce GSM-102 credit by $2 billion in fiscal year 1988 and to eliminate GSM-103 credit altogether.

Question: What will be the impact of these proposals on exports?

Answer: The principal impact will be in program administrative effort, and not in export levels. For example, in fiscal year 1985 and 1986, we announced over $4 billion in credit guarantees in order to actually register $2.5 billion. A $3.0 billion authorization level may require more monitoring of program use and the reallocation of credit guarantees from one country to another. Assuming the level of registered credit guarantees continues near the 1985 and 1986 levels, the $3.0 billion authorization should be sufficient.

The Administration is not planning to eliminate the GSM-103 credit guarantee program. In fiscal year 1986, a total of $377 million of credit guarantees were made available and $13 million approved. In fiscal year 1987, we anticipate greater use of this program.

COMMERCIAL EXPORT CREDIT PROGRAMS

Question: Won't this initiative erode progress that has recently been made in gaining access to new markets.

Answer: We believe the proposed program levels are sufficient to maintain the emphasis on GSM-102 and GSM-103, assuming a continuation of current market conditions.

Question: When does the Administration plan to forward this legislation to Congress?

Answer: The Administration has already forwarded proposed legislation to Congress to reduce the GSM-102 program from $5 billion to $3 billion.

DAIRY TERMINATION PROGRAM

During fiscal year 1986, FAS arranged sales with Brazil for 198 million pounds of red meat available under the Dairy Termination Program. In addition to commendable negotiations in this sale, the General Sales Manager and his staff should be complimented on transactions with Argentina, Egypt, the Dominican Republic, and others in coordination with the Dairy Termination Program objectives.

Question: Under the Dairy Program, how many cattle have been exported under the EEP, through Export Credit programs, or through regular commercial sales.

Answer: Under the Export Enhancement Program over 30,000 head of cattle have been sold. In fiscal year 1986, about 1,400 dairy cattle were exported under GSM-102 and 700 head under GSM-103. In fiscal year 1987, $1.9 million have been registered under GSM-102 for breeding stock, which includes dairy cattle, embryos and semen. Under GSM-103 $6.2 million has been registered for breeding stock in fiscal year 1987. Since the inception of the Dairy Termination Program, approximately 55,000 head of cattle have been certified for export.

Question: What can FAS do to increase export of dairy cows?

Answer: Greater use of GSM-102 and GSM-103 credit guarantee programs can help increase U.S. exports of dairy cattle. In addition, market promotion activities will continue to be used through the FAS Cooperator Program.

Questions: Are you still pursuing this area in light of the continuation of the Dairy Termination Program until September of this year.

Answer: All of the above programs are still active. Under EEP, about 22,000 head of dairy cattle are available for export. In addition, so far in fiscal year 1987, $24.1 million have been announced under GSM-102 for breeding stock, which includes dairy cattle, embryos and semen. Under GSM-103 $153.5 million has been announced for breeding stock.

DAIRY TERMINATION PROGRAM

Question: Are any of our neighbors in the Western Hemisphere importing dairy cattle from the U.S.?

Answer: Countries in the Western Hemisphere are our largest market for dairy cattle exports. Dairy cattle exports under the Dairy Termination Program from May 1986 through March 1987 were approximately 34,000 head to Mexico, 13,000 head to Canada, 2,000 head to Venezuela, 1,600 head to Ecuador, 600 head to Honduras and smaller amounts to Argentina, Bermuda, Colombia, El Salvador, Guatemala, Peru and Brazil.

Question: Has the Dairy Export Incentive Program been implemented?

Answer: The program was implemented on February 6, 1987.

Question: Are final regulations in place?

Answer: The details of the program were issued on February 6, 1987, and the program is now operational.

Question: What are your plans for this program?

Answer: The law mandates that the program be effective through fiscal year 1988. We have no plans to operate the program beyond the time required by the legislation. There are no plans at this time to make any changes to the current operating procedures of the program.

Question: What is the level of dairy donations anticipated in fiscal year 1987 and in fiscal year 1988 under Section 416?

Answer: We anticipate Section 416 dairy donations at approximately 122,000 metric tons in fiscal year 1987. This estimate includes 88,600 metric tons of nonfat dry milk, 18,600 metric tons of butter/butter oil and 15,000 metric tons of cheese.

In fiscal year 1988, donations of CCC-owned dairy products under Section 416 will be difficult due to the limited supplies in CCC inventory. This year, CCC stocks have been drawn down by large sales which were not foreseen earlier in the year. Domestic and foreign donations have also reduced inventories. The success of the Dairy Termination Program is resulting in fewer dairy commodity purchases by ASCS. At this time we believe that any CCC inventory available for fiscal year 1988 will be fully used in domestic feeding programs and P.L. 480, Title II donations.

QUESTIONS SUBMITTED BY SENATOR SASSER

FOREIGN MARKET DEVELOPMENT

Mr. Kay, my home of Tennessee is one of the largest tobacco producing states in America. We continue to see problems for our tobacco farmers as the demand for tobacco products is decreasing across America. The tobacco farmer may be forced in the future to look to tobacco exports to provide him income.

Question: What type of foreign market for tobacco do you foresee, and what can the Foreign Agricultural Service do to increase our tobacco exports?

Answer: The competition for high quality, lower priced tobacco is intensifying. Recent changes in the tobacco legislation have improved the price competitiveness and thus the opportunity for U.S. tobacco in the world market place. We see the greatest possibilities for expanding U.S. tobacco exports to those countries which are now just beginning to produce or are expanding production of a blended cigarette. Under the TEA program, the U.S. tobacco industry has identified several countries in the Middle East, Asia and North Africa to carry out multi-year activities designed to expand the use of U.S. tobacco. A possible EEP program to counter subsidized tobacco exports is under review. These actions are in addition to the regular market development program activities undertaken in cooperation with the U.S. industry. Export credit guarantees of tobacco under GSM-102 and GSM-103 amount to $41 million and $20 million respectively in FY 1987. We expect that availability in FY 1988 will fully cover the U.S. industry's needs.

EFFORTS TO BALANCE WORLD PRODUCTION LEVELS

Question: Mr. Amstutz, I am concerned about foreign governments that continue to subsidize their farmers to produce commodities which are already in abundance in world markets. Members of the panel have touched on this problem today. Would you further comment on USDA efforts to balance world production levels?

Answer: Production surpluses resulting from too much government support and protection of agriculture are a global problem. Until nations join together in reducing incentives to production, independent, unilateral efforts will have limited effects. As the Payment-in-Kind--PIK--acreage reduction program in 1983 unfortunately demonstrated, unilateral production cuts in the U.S. are quickly overtaken by increased production by our competitors. It is for this reason that we are focusing our efforts on achieving a global solution to the problems of surplus production in the Uruguay Round of multilateral trade negotiations.

OFFICE OF INTERNATIONAL COOPERATION AND DEVELOPMENT

QUESTIONS SUBMITTED BY SENATOR BURDICK

SPECIAL FOREIGN CURRENCY RESEARCH PROGRAM

The justification for elimination of the Foreign Currency Research Program states that in recent years, the types of currencies determined to be in excess by the Department of Treasury has declined and thus the availability of currencies for this program has diminished.

Question: If the Foreign Currency Program is eliminated, how will the U.S. maintain its work on exotic animal and plant diseases, since this type of research is not conducted in the United States?

Answer: To the best of my knowledge, these funds, along with a small Collaborative Research program also administered by the International Research Division of OICD, are the only funds available to USDA to conduct research on exotic animal and plant diseases outside the U.S. Research on exotic animal and plant diseases within the U.S. must be conducted in quarantine facilities. Termination of this program will therefore end those USDA programs outside the U.S. when current active projects are completed in 3 to 5 years.

Question: How will the U.S. obtain and evaluate plant and animal germplasm or biological control materials not available in the United States without this program?

Answer: As with research on exotic plant and animal diseases and pests, some work could continue under the funds remaining for the Collaborative Research program. OICD also has a scientific and technical cooperation program where some limited exchanges with other countries to collect germplasm and biological control materials could be possible. Termination of the Special Foreign Currency Research program would greatly reduce the effort made to obtain and evaluate plant and animal germplasm or biological control measures not available in the United States.

Question: Is there some other government supported program by which agricultural scientists may benefit by translated works?

Answer: I believe the National Agricultural Library has agreements with certain foreign libraries whereby materials are exchanged. This does not provide flexibility for translating materials of particular importance or interest to us, however, and I am not aware of any other program that systematically provides the opportunities afforded by the special foreign currency translation program.

Question: What research projects have had marked success under the foreign currency research program?

Answer: Associates in Rural Development, Inc., in Burlington, Vermont, have just completed an extensive assessment of the impact the Special Foreign Currency Research Program has had between 1958 and 1985. It outlines a number of successes. I will be happy to supply a copy of the complete report for further information.

Question: Could you please provide the committee with the amount of Foreign Currencies that have been held by the U.S. Treasury over the past ten fiscal years. Also, would you please provide the amount of foreign currencies made available to the Foreign Currency Research Program for the same period.

Answer: We do not have information readily available regarding the amounts of foreign currencies held by the Treasury for the past 10 years. However, we can provide a listing of the "excess" and "near excess" countries for the past 5 years, as well as a listing of the current countries where foreign currencies are avaiable to USDA through agreements containing "Currency Use Provisions". The information follows:

Excess Currency Countries

1983	1984	1985	1986	1987
India	India	Poland	Poland	Poland
Pakistan	Pakistan	Pakistan	Pakistan	Pakistan
Burma	Burma	Burma	Burma	Burma
Guinea	Guinea	Guinea	Guinea	Guinea
		India		

Near-Excess Currency Countries

1983	1984	1985	1986	1987
Taiwan	Czechoslovakia	Ghana	Ghana	India
Yugoslavia	Egypt	Sudan	Sudan	Sudan
	Ghana	Taiwan	Taiwan	Taiwan
	Poland		India	
	Sudan			
	Yugoslavia			

Currency Use Provision (CUP) Countries -- 1987 availabilities

Costa Rica
Dominican Republic
Ecuador
Egypt
Ghana
Guatemala
Guyana
Indonesia
Kenya
Mozambique
Peru
Philippines
Sierra Leone
Somalia
Sri Lanka
Tunisia
Yemen
Zaire
Zambia

The amount of foreign currencies used for OICD special foreign currency research activities has been:

1983 -- $5 million
1984 -- $5 million
1985 -- $5 million
1986 -- $3 million
1987 -- $2.5 million

According to your Agency's background information, the OICD Agribusiness Information Center is fully operational.

Question: What are the services that this information center is providing and in what countries?

Answer: The Information Center is a resource to potential investors in the Caribbean and in Central America. It maintains a network of contacts with U.S. and Caribbean Basin entities, chambers of commerce, embassies, trade associations and cooperators that trade and invest in the Caribbean Basin and the United States and acts as a clearinghouse for processing and transmitting agricultural investments, trade, marketing and technical agricultural inquiries to other resources.

COLLABORATIVE RESEARCH PROGRAM

Coupled with the elimination of the Foreign Currency Research Program, it appears that any reduction in collaborative research activities could have a dramatic impact on U.S. involvement in foreign-based agricultural research projects.

Question: What is the reduction planned for international cooperative research in fiscal year 1988?

Answer: Funding for collaborative research would be reduced approximately one-third from its fiscal year 1987 level of some $400,000.

Question: What will be the full amount spent on cooperative and collaborative research activities under the administration's proposed fiscal year 1988 budget?

Answer: The Special Foreign Currency program would be eliminated, and the collaborative research activities reduced to approximately $265,000.

Question: How does this amount compare with fiscal year 1987?

Answer: In fiscal year 1987, the Special Foreign Currency program was funded at $2.5 million and the collaborative research activities at roughly $400,000.

INTERNATIONAL TRAINING ACTIVITIES

Question: Is there another U.S. government agency that administers and designs comprehensive training programs in agriculture and rural development to help other nations improve their agriculture economy?

Answer: No, there is no other government agency that administers and designs comprehensive training programs in agriculture and rural development. The key words are "comprehensive and agriculture". There are other government agencies that provide training, but not in agriculture. The Agency for International Development (AID) does not administer and design comprehensive training programs in agriculture. AID utilizes the services of the

International Training Division of OICD through the mechanism of a Resource Services Support Agreement (RSSA) to provide training programs in agriculture.

Question: Without funds for these programs, how would self-help measures in P.L. 480 Agreements be accomplished?

Answer: OICD assists with P.L. 480 self-help measures by coordinating the Department's international technical assistance and training activities. This gives OICD a unique perspective which is sought to help ensure that P.L. 480 Title I and III resources are used in ways which will accelerate agricultural and economic development in recipient countries; benefit the rural poor; and are consistent with USDA program interests and market development activities. Reduced funding would simply mean less involvement by OICD in these activities. Because of the potential for mutual benefits, other USDA agencies would undoubtedly be requested to expand their staff time to continue the Department's involvement in self-help activities. In other words, the effort would continue, but with less linkage with the Department's international development activities that are coordinated by OICD.

Question: Would FAS or AID provide services which were formerly part of OICD's responsibilities?

Answer: Because OICD's mission and programs are unique, it would be highly unlikely that FAS or AID would be able to continue the activities proposed for elimination or funding reduction. ISEC provides a linkage between USDA and the university community on international development programs, for example, so it is not an appropriate AID function. Likewise, it would not be an FAS interest since OICD is the agency responsible for the Department's international development efforts.

OICD's overseas research programs operate under authorities not available to other agencies. The Middle Income Country Training Program builds on OICD's international training capabilities which have been developed over more than three decades, and works with countries that have "graduated" from AID eligibility because of their average per capita income levels.

In sum, while OICD collaborates with a number of other agencies and there is significant support from others regarding our activities, it would be difficult for them to implement our programs because of authorities or funding restrictions.

QUESTION SUBMITTED BY SENATOR SASSER

Question: I was pleased that your testimony identified some specific research results and other benefits that will help our own farmers. Could you outline how your programs might affect the American producer--what benefits might a farmer in Tennessee receive from OICD programs?

Answer: OICD's goal is not only to help developing nations but to help our own producers in the process. I see this happening in many ways.

Our overseas research and scientific cooperation programs are providing valuable data at a fraction of the cost of similar research in the U.S. and often on topics that would not be possible here such as exotic diseases and pests that present potential dangers to us, but have not yet been introduced here. They are providing new germplasm to help us improve our varieties. This is helping our farmers produce more efficiently by providing them with better, less expensive production tools--the new varieties, new technology such as biological control methods, solutions for eradicating or controlling diseases and pests, or other similar information.

These research and scientific exchange activities are also finding new uses for agricultural products, or solving problems that have prevented expanded use of these commodities in the past. This is expanding utilization both here and overseas.

The increased utilization I just mentioned is one form of market development, something which is very important. Other programs are providing more instant market development opportunities. The Middle Income Country Training Program, for example, is often providing immediate sales of commodities, goods, or services as well as follow-on sales. A 1985 program participant bought veterinary supplies while here and just this year returned at his own expense to buy 500 head of dairy cattle. Our Agribusiness Information Center works directly with the private sector to help expand their investment opportunities and exports.

Efforts to develop insect resistant packaging, or tests of in-transit fumigation of grains, are other ways to help us be more competitive in world markets by delivering a better quality product or by responding in a more efficient manner.

Most of our programs are designed to foster relationships between countries that affect not only trade, but also have political and security implications.

QUESTIONS SUBMITTED BY SENATOR McCLURE

INTERNATIONAL RESEARCH ACTIVITIES

I would like to address my questions to Dr. Joan Wallace, the Administrator of OICD. The pea and lentil producers in Idaho are concerned that the United States is spending an inordinate amount of research funds on international cooperative research in cool season legume research with no direct benefits to U.S. producers. They point to the international research efforts in the Middle East which do research on peas and lentils but very often do not share their research results with anyone. I am interested in helping fund a program which would enhance current research efforts to address some of the more urgent needs to cool season legumes. What I envision is an International Cool Season Legume Research Institute which will plan, develop, coordinate and evaluate research programs, investigate research opportunities, organize and contract for technical resources, and receive and manage funds. A special aim of this Institute will be to encourage and support research into agricultural problems of developing countries in those fields in which U.S. legume researchers have special competence.

Question: What kinds of research is OICD most interested in?

Answer: Over the last 25 years our activities have been equally divided among entomology, plant science, animal and veterinary science, and forestry. In recent years, increasing attention has been focused on utilization research (i.e., searching for new products, new processes and new markets for our exports). For example, research to expand the use and consumption of legumes, in cooking oil, bread, meat substitutes, animal feeds and many other products, will lead to larger markets for U.S. legumes, a crop group which generally exports 80% of its production.

Question: Where are the centers of excellence in legume research right now?

Answer: First, I must point out that the U.S. has considerable expertise in legume research. Michigan State University currently coordinates a research program on cowpeas and field beans. Illinois does the same for soybeans and, Idaho, among several Western states, works with dry beans and lentils. USDA research stations carry out research on developing stress-tolerant plants and cropping systems.

Overseas, there are international agricultural research centers that concentrate on legume crops - in Syria (ICARDA), in India/Africa (UCRISAT), and in Colombia (CIAT). There are also some national agricultural research centers with expertise in legumes, such as those in Australia, Mexico, and India.

Question: Does the USDA collaborate with these centers and their research programs? How?

Answer: Our scientists often visit these centers and are familiar with their work through professional exchanges of various kinds, but we have not established a collaborative research program with these centers.

Question: Who funds the research work at these international centers?

Answer: USAID funds about 25% of the core funds annually, but this varies center by center, among the 12 or 13 centers which are members of the consultative group.

Question: Are U.S. agricultural scientists interested in expanding legume research with these centers?

Answer: Yes, in fact, one of the projects we manage for AID is doing this. Our Special Foreign Currency and Collaborative Research Programs are also moving in the direction of increased legume research.

There is no doubt that research with legumes in the areas of improving utilization and processing procedures, and in reducing production constraints under stressed conditions, will lead to an expanded market for U.S. exports. A recent study called "Assistance to Developing Country Agriculture and U.S. Agricultural Exports: Three Perspectives on the Current Debate," prepared for the USDA Extension Service by Dr. Earl Kellog, from the Consortium for International Development, Tucson, Arizona, highlighted this fact.

Question: How do the Special Currency and Collaborative Research programs operate?

Answer: Research topics are identified which are of interest to U.S. scientists at U.S. institutions - USDA agencies, laboratories or installations throughout the U.S., 1862 and 1890 land-grant universities, plus Tuskegee; and other research institutions in both the private and public sector. OICD funding constitutes a catalyst to focus the research resources of U.S. and foreign institutions on agricultural problems that are of mutual interest and benefit to both countries. The research must benefit U.S. agro-industry or it is not funded. The programs help cover research costs at overseas institutions as well as provide U.S. scientists with modest funds for travel, supplies, technician assistance, etc., to carry out joint projects with foreign counterparts.

QUESTIONS SUBMITTED BY SENATOR GRASSLEY

BENEFITS TO U.S. LIVESTOCK INDUSTRY

Question: Your testimony has outlined a number of program results. Could you now focus specificall, on the livestock industry and summarize for us some of the ways your programs affect that group?

Answer: Since the early 1960's, the Special Foreign Currency Research program has funded research projects on breeding adapted strains of dairy and beef cattle for increased productivity. Twelve projects in seven countries have produced results that are fairly consistent and can be generalized. This research has universally found that the productivity of indigenous strains of both dairy and beef cattle can be enhanced through crossbreeding with pure strains which are externally introduced.

Most of these projects have involved the introduction of U.S. breeds to indigenous herds. Of special interest to us has been research results showing that offspring from U.S. Holstein-Friesian cattle crossed with indigenous strains are the most productive in terms of milk, percentage of butterfat and protein. Research has also confirmed that U.S. cattle are the best value for adapted breeding programs.

Research data such as this has had a significant effect on the U.S. cattle industry; a great number of live animals have been exported to many countries. Recently, with improved semen preservation and artificial insemination techniques, sales of U.S. cattle semen have increased, an obvious benefit for American farmers. While not all of this can be attributed to research funded by the SFC program, it should be emphasized that SFC projects on adapted cattle breeding were among the first in the world. This research exposed many foreign countries, in addition to those where the SFC projects took place, to the idea that milk and meat production could be increased through the introduction of outside strains of cattle.

USDA records indicate that between 1976 and 1984, sales of live beef and dairy cattle from the United States to all other countries exceeded $404 million. According to the U.S. National Association of Animal Breeders, during this same period, U.S. beef and dairy cattle semen sales overseas were more than $137 million. These sales have been a great benefit to U.S. agriculture as well as increasing beef and dairy cattle productivity around the world. The SFC agricultural research program has played an important role in this process.

Listeriosis, an unusual disease found in livestock, can be lethal when transmitted to humans. It is caused by the bacteria Listeria monocytogenes, which occurs naturally in silage and is ingested by animals. The disease has been a recurring problem in the United States, particularly in cattle and sheep. Within the last two and a half years, Listeriosis has been linked to 58 human deaths during two outbreaks in the United States. The first of these occurred in Massachusetts between June and August 1983, with 14 deaths linked to milk consumption. In June 1985, 44 deaths in California were linked to the consumption of U.S.-manufactured, Mexican-style cheese. Recent research at the Center for Disease Control in Atlanta, which investigated the Massachusetts outbreak, has suggested that L. monocytogenes may have survived proper pasteurization procedures used to process the milk linked to the deaths. It has become obvious to U.S. researchers and public health officials that the nature of listeriosis, its pathogenes and route of transmission to food are not completely understood and demand intensive, continuing study. The recent human deaths emphasize this need. The impact of this SFC research, is potentially far-reaching.

Cooperative research between Yugoslavian and U.S. scientists under the auspices of the SFC program in listeriosis is a prime example of the merits of international scientific cooperation. The expertise of Yugoslavian scientists, coupled with the high incidence of listeriosis in that country, has facilitated efforts of U.S. scientists to understand this elusive disease. The SFC agricultural research program can take much of the credit for supporting scientific advancement in confronting the problem of listeriosis.

Another SFC project conducted in Egypt dealt with epidemilogical and immunological aspects of South African horse sickness disease which continues to plague Africa, the Middle East and Asia and is currently among the most important potential threat to U.S. domestic animals. New information gained as a result of this research is that the disease which is lethal to horses, is caused by an arthropod virus and, thus, disappears during the cold months then reappears. Originally, scientists believed that the disease was transmitted by mosquitoes, but the SFC research found that a tick is the source of transmission. This tick is unique in that it can be a reservoir of the disease in any country. This disease is not currently present in the United States, but in the event that this country ever faces the dread disease, testing and diagnostic capabilities do exist at Plum Island. The United States does maintain seed virus vaccine, made possible as result of this research, for the nine virus types of this disease.

BENEFITS TO U.S. CROP PRODUCERS

Question: How about the crop producers? How do your programs affect them?

Answer: SFC research in plant science has involved conducting both basic and applied research that resulted in substantial benefits to both the United States and the cooperating countries. In many cases the basic research has led to the relatively immediate application of the new information to production problems in either country. In most cases the basic research has produced information, new genetic materials and/or new techniques and processes which will be used in the course of applied research for decades, if not centuries, beyond the period of original research. The majority of SFC research in this scientific area has been in plant germplasm collection, screening, evaluation, and breeding for increased genetic diversity (in relation to disease resistance, plant productivity, stress tolerance and quality characteristics).

Regarding plant germplasm collection and breeding research, the predominant benefit to both the United States and the cooperating country has been with respect to mutual germplasm exchange. However, because the United States has been the fixed partner in a round table of 24 participating countries, there is no doubt that the benefit to the United States has been far greater than that experienced by any other single country. Germplasm collection and breeding research has taken place in the majority of cooperating countries. Screening and evaluation work has yielded a wealth of new information and plant materials (which have been added to U.S. permanent collections) with regard to botanical and compositional characteristics of hundreds of thousands of plant species. This information and these materials are available to U.S. scientists looking for new sources of biologically active compounds, new fatty disease resistance and stress tolerance that will meet developing and constantly changing needs of industry, agriculture and medicine in the United States. Had this research not taken place, it is likely that much of this invaluable resource would not be available for collection and research today or in the near future, due to the ravages of increasing environmental degradation and the expansion of populations into biologically rich native areas.

Sugarcane is an important commercial crop in the United States. However, because it is a tropical plant, U.S. breeders have difficulty getting the plant to flower, except under expensive laboratory conditions. Because of a long-standing collaborative research relationship between the United States and India, fostered through various SFC projects, U.S. breeders have had the opportunity to conduct breeding and varietal selection under tropical conditions in India. This program has been beneficial to U.S. agriculture in several ways. It has allowed U.S. scientists to conduct a breeding program that would otherwise have been quite expensive. In addition, annual breeding "capacity" has been increased threefold. Thus, the number of clones that can be obtained yearly have gone from an estimated 40 to 120, enabling a much more rapid varietal selection process. Of potential specific benefit for U.S. sugarcane producers is the recent discovery of a cane variety in the Himalayan foothills that is extremely tolerant of cold weather. If U.S. breeders are able to introduce this Indian variety into U.S. varietal lines, the results will extend the sugarcane growing season and assure increased productivity for U.S. producers. This would greatly expand the area in the U.S., perhaps to our Canadian border, where sugar cane could be grown.

Wheat leaf rust is a major production problem in the United States that affects not only soft wheat, but varieties of spring and winter wheat as well. The disease decreases yields by reducing both test weight and the number of seeds set. Germplasm was identified under SFC projects in both Egypt and Yugoslavia and that demonstrated resistance to wheat leaf rust. USDA scientists are currently doing a major evaluation of these materials and others for resistance to all diseases known to affect U.S. production. The results of this evaluation program will permit the selection of improved parent material for commercial varietal seed breeding programs.

Alfalfa production in the United States owes its existence to exotic varieties which have been transferred from Middle Eastern and

Asian countries. One of the most popular varieties came from Egypt during the 1950's. U.S. researchers require continued access to these "native" alfalfa-growing regions to improve alfalfa production in the United States. Under one SFC project in Egypt an alfalfa germplasm was identified which displayed resistance to spotted aphid disease, a major problem which decreases the productivity of alfalfa grown in the United States. This variety has been transferred to U.S. breeders and subsequently has been introduced into commercial production here as a result of work done in Egypt under P.L. 480.

Similarly, rice is not a native plant of the United States. Essentially, everything that is known by U.S. scientists about rice production has been obtained through international research efforts, including the P.L. 480 program. As a result of one SFC project in Pakistan, a total of 1,365 lines of rice were selected and transferred to the USDA World Collection of rice germplasm. Initial evaluation work revealed varieties resistant to stem rot disease and blast, and tolerant to salinity and cold. These rice varieties have been made available to U.S. rice breeders for inclusion in rice breeding programs for commercial introduction. Currently, these rice varieties (along with the remainder of the 16,000 accessions in the World Collection) are being reassessed for evaluation of all characteristics. In addition, many varieties are currently under state/federal cooperative evaluation in Arkansas, Louisiana, California and Texas for resistance to sheath blight, blast, brown spot (Helminthosporium), and insects, especially rice water weevil. This work is extremely important to U.S. rice producers in that improved commercial varieties of rice become available to farmers only through federal and state cooperative programs.

Another SFC project in Yugoslavia contributed information which improved sunflower oilseed production revolutionized U.S. production and resulted in superior oil content, numbers and weights of seeds, and other critical production characteristics. In addition, several sources of resistance to downy mildew have been discovered, which are of particular significance with the recent discoveries of new virulent strains of downy mildew in the United States. Breeding material, research results and researchers continue to be shared between the two countries, bridging the gap between the United States and other Eastern European countries and providing avenues of exchange.

Question: Isn't it true that you are recommending the reduction or elimination of some of these programs?

Answer: Yes, it is true. The examples cited from the Special Foreign Currency and collaborative research program areas would continue until their current funding expires, usually in 3-5 years, but there would be no new foreign currency projects initiated, and the collaborative research efforts would be curtailed.

Question: In view of the poor farm economy, is this the time to be reducing these programs?

Answer: While the programs provide substantial benefits to American producers the Administration was required to make difficult choices among programs in order to meet the deficit reduction targets of the Gramm-Rudman-Hollings Act.

Questions Submitted by Senator Domenici

Question: Would your department/agency favor a biennial budget process? What benefits would your agency achieve in a two-year appropriation cycle?

Answer: The Office of International Cooperation and Development would benefit from a biennial budget in several ways. Staff time spent on budget preparation could be used more effectively in planning and execution of the budget. Program management would be affected positively by allowing managers an early and stable funding level to plan program activities.

Question: Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer: Although OICD's appropriation is less than 15% of our total fiscal year budget, historically approximately 80 to 95 percent of our annual request is repetitious. Because most reimbursable programs are ongoing and budgets are multi-year, funding levels could be accurately reported on a biennial basis.

Question: What difficulties can you foresee in preparing and submitting a two-year budget to Congress?

Answer: We do not forsee any major difficulties.

Question: Would you expect to realize any budget saving if you could plan your agency on a two-basis? If so, could you estimate how much?

Answer: OICD would not realize any significant budget saving but would probably save close to a half staff year annually that could be used more effectively.

SUBCOMMITTEE RECESS

Senator Burdick. This concludes today's hearing. We appreciate your having been here today to share with us your views on the fiscal year 1988 appropriation for the Department of Agriculture.

Our next hearing will be held tomorrow, Wednesday, in this same room, beginning at 10 a.m. At that time we will hear from the representatives of the Commodity Futures Trading Commission and the Food and Drug Administration.

Until then, the subcommittee stands in recess.

[Whereupon, at 11:25 a.m., Tuesday, March 31, the subcommittee was recessed, to reconvene at 10 a.m., Wednesday, April 1.]

AGRICULTURE, RURAL DEVELOPMENT, AND RELATED AGENCIES APPROPRIATIONS FOR FISCAL YEAR 1988

WEDNESDAY, APRIL 1, 1987

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10 a.m., in room SD–138, Hon. Quentin N. Burdick, (chairman) presiding.

Present: Senators Burdick, Cochran, and Grassley.

COMMODITY FUTURES TRADING COMMISSION

STATEMENT OF SUSAN M. PHILLIPS, CHAIRMAN

ACCOMPANIED BY:
MOLLY BAYLEY, EXECUTIVE DIRECTOR
RUSSELL CHERRY, BUDGET DIRECTOR

INTRODUCTION OF WITNESSES

Senator BURDICK. Good morning, ladies and gentlemen. Welcome to the hearing of the Subcommittee on Agriculture, Rural Development and Related Agencies, as we continue our review of the fiscal year 1988 budget.

This morning we are joined by Susan Phillips, Chairman of the Commodity Futures Trading Commission, and Dr. Frank Young, Commissioner of the Food and Drug Administration.

We look forward to hearing from each of you on the progress made during the fiscal year 1987 and on plans for fiscal year 1988.

We will begin with the Commodity Futures Trading Commission.

Chairman Phillips has had the arduous task of complying with the new mandates of reauthorization legislation passed in the 99th Congress. She will explain how the Commodity Futures Trading Commission is responding to this legislation, and to the oversight and enforcement demands of an industry that has grown tremendously over the past decade.

Currently there are over 120 futures and options markets for a variety of commodities, with a 98-percent growth in the volume of trading during the past 5 years alone.

The Commodity Futures Trading Commission has had to develop new ways to meet the demands of this rapidly changing and growing industry, including improving computerization and coordination with self-regulatory organizations.

In fiscal year 1988, the Commission is requesting $3 million over its fiscal year 1987 level of almost $30 million for its operations.

Chairman Phillips, welcome to the committee. Your statement will be made a part of the record in full, and you may summarize to the extent that you feel necessary.

STATEMENT OF MS. PHILLIPS

Ms. PHILLIPS. Thank you, very much, Mr. Chairman. I appreciate the opportunity to appear before you today to summarize our 1988 budget request. I am accompanied today by Molly Bayley, the Executive Director of the Commission, and by Russell Cherry, our Budget Director.

I will submit written testimony for the record, and I will try to highlight that testimony for you here today.

The Commission's budget request of $32.8 million does represent an increase of approximately $3 million over the 1987 level. This requested level will allow the Commission to recover some anticipated increases in operating expenses and to fund 518 staff-years—this is an increase of 10 over our 1987 level. We would anticipate allocating these additional 10 staff-years to our surveillance and enforcement programs; 8 to enforcement, and 2 to surveillance.

In addition, the requested increase will allow the Commission to fund improvements in our financial management system.

We believe these increases will help the Commission keep pace with the tremendous growth in the futures and options markets. We have attached to our testimony selected statistics on both the industry's growth and several of the CFTC's programs. I would point out that volume has nearly doubled in the last 5 years.

The number of contracts that the Commission must now oversee has increased about 50 percent over this period, and CFTC's staff has increased about 3 percent.

In our enforcement program, as you can see, the number of cases that we have filed has decreased. However, the enforcement division is concentrating on larger, more complicated cases. This is resulting in larger penalties and fines; more people are affected in the cases; more persons have been prohibited from trading; and the division reports that they are now spending a lot more time on litigation.

In the past, they used to spend about one-third of their time on litigation; now they are spending about one-half of their time on litigation. This is a result of the fact that they are looking at more complicated cases.

In our other programs, the Commission has in the past and will continue to try to accommodate industry growth by streamlining, computerizing some of our programs and operations, reexamining programs and reallocating resources internally, delegating appropriate functions to self-regulatory organizations and encouraging antifraud enforcement actions by the states.

Keeping pace is not just a matter of adjusting to the increased volume of trading. We must also keep pace with the changing nature of the markets. New types of contracts are bringing new participants into the markets, and new technology is changing the way trading is done.

Cash markets seem to be in a constant state of flux and this has a certain kind of spinoff effect in the futures and options markets. The markets are becoming more international. These shifts in the nature of the markets are causing the Commission to examine, in some instances, some of our very fundamental programs.

For example, in the last year, we have been looking at possible alterations to the net capital rules; exchange of futures for physical transactions; we have been looking more recently at program trading in the stock index and stock options market; off-exchange instruments; we have been working to improve exchange audit trails; and in the international area, developing foreign futures and options rules, and information sharing agreements with foreign governments to support our enforcement program.

As we finish 1987 and move into 1988, the Commission will continue to implement the changes required by reauthorization legislation which, as you mentioned, became law last November.

With the exception of leverage regulation, most of the changes will have little or no resource implications for the Commission. The leverage portion of the legislation does, however, require the Commission to undertake a survey of the industry in conjunction with the National Futures Association.

This is to determine which firms are interested in entering the precious metals leverage business. Following the survey, the Commission will determine the most appropriate regulatory structure for an expanded leverage industry and report to Congress on the findings of the survey and our regulatory recommendation.

Although it is unclear at this time what effect these requirements will have on the Commission's resources in the future, the Commission expects to be able to absorb any additional resources needed in fiscal year 1987, and at its requested fiscal year 1988 level.

In conclusion, the Commission's request of $32.8 million will allow the Commission to fund increases in operating expenses, improvements in its financial management system and put additional resources into enforcement and market surveillance.

We believe this request to be a modest one reflecting our desire to carry out our mission effectively without unduly adding to the cost of government.

Mr. Chairman, I appreciate the opportunity to appear before you and will be pleased to answer any questions you may have.

PREPARED STATEMENT

Senator BURDICK. Thank you, Ms. Phillips. We will make your complete statement part of the record.

[The statement follows:]

STATEMENT OF SUSAN M. PHILLIPS

I appreciate the opportunity to appear before you today to summarize the FY 1988 budget request of the Commodity Futures Trading Commission. I am accompanied today by Molly Bayley, the Executive Director of the Commission, and by Russell Cherry, the Budget Director.

The FY 1988 budget request for the Commission is $32,813,000, an increase of $3,052,000 over the estimated FY 1987 level. The requested FY 1988 level will allow the Commission to cover some anticipated increases in operating expenses and to fund 518 staff-years, an increase of 10 over the funded FY 1987 staff-year level of 508. These increased staff-years will allow the Commission to direct additional resources towards enforcement and market surveillance. More specifically, eight of those staff-years would be allocated to enforcement and two to market surveillance. In addition, the requested increase will allow the Commission to fund improvements in its financial management system to ensure more effective management of the Commission's resources.

Although these increases are small, they will nevertheless assist the Commission in keeping pace to some extent with the tremendous growth in the futures and option markets. The volume of trading has grown sixfold in the ten years between 1976 and 1986, with an increase of 98% in the last five years (see table attached). There are now 92 futures markets and 30 option markets in a wide variety of commodities. The Division of Enforcement has spent more time during the past year in litigation and concentrating on larger, more complicated cases. The Division's work also has resulted in greater penalties and fines. In its other programs, the Commission has in the past, and will in the future, also endeavor to accommodate industry growth by streamlining or computerizing certain programs or operations, re-examining programs and reallocating resources internally, delegating appropriate functions to self-regulatory organizations and encouraging antifraud enforcement actions by states.

Keeping pace is not just a matter of adjusting to the increasing volume of trading. The Commission must also keep pace with the changing nature of the markets. New types of contracts bring new participants in the markets, and new technology is changing market operations and trading strategies. And, as always, the cash markets are in a constant state of flux, which has a spinoff effect on the futures and option markets. In addition, the increasing internationalization of futures and option trading has further expanded the availability of these markets.

These shifts in the nature of the markets bring new and often difficult issues before the Commission. Within the last year, the Commission has examined such issues as the possible alteration of net capital rules; transactions involving the exchange of futures for physical commodities; program trading in stock index futures and option markets; the applicability of the Commodity Exchange Act to a variety of off-exchange instruments; and the improvement of exchange audit trails which track the timing and sequencing of trades. In addition, international issues have placed an increased demand on the Commission. For example, the Commission is considering new rules to govern the offer and sale of foreign futures and options in this country. In addition, this year the Commission signed a memorandum of understanding with the United Kingdom for information sharing purposes in support of our enforcement programs. We also have similar agreements with a number of other countries.

The Commission will continue to be faced with these issues in FY 1987. In addition, the Commission will continue to implement the changes required by the Commission's reauthorization legislation which became law last November. With the exception of leverage regulation, most of these changes will have little or no implications for Commission resources. The leverage portion of the reauthorization legislation requires the Commission to undertake a survey of the industry, in conjunction with the National Futures Association, to determine which firms are interested in entering the precious metals leverage business. Following the survey, the Commission will determine the most appropriate regulatory structure for an expanded leverage industry and report to the Congress on both the findings of the survey and its regulatory recommendations. Although it is unclear at this time what effect these requirements will have on Commission resources in the future, the Commission expects to be able to absorb any additional resources needed in FY 1987 and its requested FY 1988 level.

In conclusion, to accomplish the Commission's goals and to address the anticipated workload for FY 1988, the Commission requests an FY 1988 appropriation of $32,813,000. This amount will allow the Commission to fund increases in operating expenses, improvements in its financial management system and the addition of ten staff-years in enforcement and market surveillance. Because of the critical role of the futures and option markets in the international economy, the Commission must be funded at a level which allows it to keep pace with the growth in size, diversity and complexity of the markets. The Commission believes its request to be a modest one, reflecting its desire to carry out its mission effectively without unduly adding to the cost of government.

I will be happy to answer any questions from members of the subcommittee.

COMMODITY FUTURES TRADING COMMISSION

FY 1982 to FY 1986

	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	% Change FY 1982-FY 1986
Trading Volume (000,000)	108	138	157	170	214	+ 98%
Actively Traded Contracts	80	93	89	106	122	+ 53%
Enforcement						
. Cases Filed	61	74	70	83	56	- 8%
. Persons Against Whom C&D's Entered	88	72	106	100	134	+ 52%
. Persons Prohibited from Trading	38	43	68	54	76	+ 100%
. Persons Sanctioned w/Civil Penalty	32	43	70	86	114	+ 256%
. Civil Penalties ($000)	$922	$3,165	$3,501	$2,789	$8,084	+ 777%

Staffing (Actual Staff-Years)	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	% Change FY 1982-FY 1986	FY 87	FY 88	% Chg. 82-88
. Market Surveillance Staff	69	69	68	67	66	- 4%	68	70	+ 1%
. Enforcement Staff	110	114	109	125	118	+ 7%	131	139	+26%
. Other Staff	289	302	315	320	296	+ 2%	309	309	+ 7%
. Total Staff	468	485	492	512	480	+ 3%	508	518	+11%

ENFORCEMENT ACTIVITIES

Senator BURDICK. The fiscal year 1988 budget request includes an increase of over $1 million and 8 staff-years for enforcement activity. Please explain the type of fraudulent activities that will be investigated, and what the Commission's priorities are with respect to illegal activities by commodity pool operations [CPO's], commodity trading advisors [CTA's], and Future Commission Merchants [FCM's], and traders or brokers who are not members of the National Futures Association.

Ms. PHILLIPS. Yes, sir; the request for 8 additional staff-years, and approximately $1 million is for an expanding responsibility generally. As volume goes up, that certainly does increase the enforcement responsibilities.

We really cannot delegate certain of our responsibilities in the enforcement area, either to exchanges or to other self-regulatory organizations, such as NFA.

They have a very limited capability of only bringing membership-kinds of actions. They do have certain fining capabilities, but they are not able to bring certain kinds of actions.

I think that we continually run somewhat of a balancing act in this area because it depends on what is happening in the markets as to what is the current, I suppose, fad area for enforcement. If it happens to be boiler-room activities, we may have to devote more resources in that area. Or, if it is dealing with the more traditional activities in the market of exchange and NFA members, we may also have to deal with that.

Generally, about one-half of the enforcement time is spent on off-exchange activities, and about one-half is spent on CFTC's registrants, which would cover CPO's, CTA's and Futures Commission Merchants.

We are also trying to get the States involved in some of the off-exchange areas, but that has been a little more difficult, although we are increasing our joint enforcement efforts. But at this point, I would have to say it is pretty much divided and we have not been able to concentrate in one area or the other. Although since we have sole jurisdiction for CFTC registrants, that is an area we have to be particularly vigilant in.

Senator BURDICK. Could you give me an example of the fraudulent activities that you are talking about?

Ms. PHILLIPS. Yes, sir; in the area of off-exchange, what we often find is that these are—I will use the slang term—"boiler-room" activities, or bucket shops. These are literally off-exchange kinds of operations where you may have a phone bank and there are a lot of high-pressure salesmen trying to attract customer money and they will say that they are for futures transactions and/or forward contracts, but those transactions never make it to the floor of an exchange.

They are literally schemes to collect money. In those situations, often what we try to do is prove that they are off-exchange futures and we can put them out of business very quickly. Since 1985, the Division has brought 24 actions in this area.

It does seem that right now, they are concentrating in the Southwest. Earlier it was Florida. A couple of years ago, I was reporting to you about our activities in the state of Florida. But things do seem to have improved in Florida. The state of Florida has gotten actively involved and passed their own boiler-room law.

That would be the predominant area in the off-exchange kind of activity.

When you are talking about either exchange activity or CFTC registrant activity, it is another kind of activity. You could be talking about trade practice violations, and those could occur on the floor of exchanges, or sales practice problems, which include high-pressure sales tactics and fraudulent misrepresentations to customers.

Also, you may have churning-kinds of violations, where brokers are just trading accounts in order to get commissions.

So those would be the kinds of things we would be looking at with respect to CFTC registrants.

Senator BURDICK. I was just wondering how you could differentiate between a high-pressure salesman and an eager salesman.

Ms. PHILLIPS. It is a difficult differentiation, I agree.

INSIDER TRADING

Senator BURDICK. How does the Commission guard against insider trading in futures markets?

Ms. PHILLIPS. In the area of insider trading, the Agriculture Committees in 1982 requested that we do a study of insider trading generally. Actually, the study was somewhat more broad. It was looking at all kinds of trading while in possession of nonpublic material information.

At that time, the Commission looked at various kinds of activity that might involve potential conflicts of interest between traders and salesmen and customer activities.

One of the key areas that came out of that report was with respect to trading ahead of your customer, which is a violation. While the exchanges have rules in this area that prevent brokers from trading ahead of their customers—in other words, if they have knowledge of large customer positions, they are not supposed to trade for their own account ahead of that information.

A problem was that the reporting devices that were currently available were not precise enough for us to be able to track that activity. The brokers on the floors of exchanges only had to report their transactions within 30-minute time brackets. So the Commission has launched a program to improve the audit trails of the exchanges and those programs are currently being put into place.

The insider trading activity that you probably have been reading about in connection with the securities market are less applicable—really not applicable—to the commodities market because you do not have the same fiduciary relationship between employees of the firm to the owners of the stock.

You are talking about whole market information as opposed to firm-specific information that is prevalent in the securities market. That is one of the reasons that the securities-type insider information laws are not applicable in the commodities market.

GROWTH IN VOLUME

Senator BURDICK. With the tremendous increase in the volume of contracts traded each month, will the Commission be able to keep pace with the investigations and enforcement requirements placed on it during the next fiscal year, assuming this budget is approved?

Ms. PHILLIPS. Yes, sir; we believe that we will be able to do so. I will say that it is requiring both us and the exchanges and NFA to streamline and computerize a lot of our operation so that we do not have to devote staff resources to manually reconstructing records and so that we will have more ready access to the data to bring cases, and to monitor the markets as trading is occurring.

We have been moving toward more online systems and encouraging the exchanges also to make those kinds of changes. Were it not for those kinds of technology capabilities, however, I don't think we would have been able to keep up with the volume.

But relying on the exchanges and NFA, increasing their responsibility and moving more toward computerization I think will allow us to keep pace.

Senator BURDICK. If an unforeseen market crisis causes an increase in the number of complaints or enforcement cases, will the Commission request more funds for fiscal year 1988?

Ms. PHILLIPS. Were that to happen, sir, I can't promise I would not be back before you. I think that you can never say "never" when you are the head of an enforcement agency, and many things can certainly happen. We are putting many of our resources into trying to prevent problems so that we don't get into the situation of having to be hit with a lot of enforcement actions, and/or customer complaints. I think what we are trying to do is enhance our prevention programs at the exchange, NFA and Commission levels so that customers are, in fact, protected and they won't have to complain and we won't have to bring the enforcement cases.

Nevertheless, you can't prevent everything and that is why we are placing increased emphasis on our enforcement program.

CATTLE MARKETS

Senator BURDICK. In recent years, the structure of the cattle industry has changed dramatically. Questions have been raised relating to the relationship between cattle futures and cash markets, the impact of the whole-herd dairy buy-out program and changes in regulations affecting the industry generally.

Has the CFTC been involved in oversight of the cattle futures markets and are you aware of any changes that might improve these markets?

Ms. PHILLIPS. Yes, sir; we have certainly been actively involved over the past year with respect to surveillance of the cattle market. About a year ago when the whole-herd dairy buy-out announcement was made there was a rapid decrease in the price of cash and futures cattle prices. The Commission has spent literally hundreds of hours responding to congressional inquiries about that program and what is going on in the futures market.

As a result of the concern about the cattle market, the Commission began publishing additional information regarding the composition of the market in an aggregated form.

We do have our large trader reporting system whereby we do know who all of the large players are in the market. One of the questions we get is, who is using those markets and are they using them for commercial, or are they using them for speculative purposes?

We have heightened our surveillance activities in that area. We also have, because we really only capture on a regular basis large trader information, authorized a special call in the cattle markets this spring to determine down to the one-contract level who is participating in those markets.

As a matter of fact, that call information is due from the FCM's today and it will reflect their position information as of March 13. In addition to that, we are meeting tomorrow with the task force from the National Cattlemen's Association and as I understand it they are going to be with us all day tomorrow.

I will be speaking with Commissioner Hineman, who is also working closely with that task force.

The exchanges are also undertaking a number of inquiries to look at what possible changes might be made to the cattle contracts. There are a lot of activities that are ongoing. The GAO has undertaken a study of the cattle markets, and of course, that is at the behest of the House and Senate Agriculture Committees.

We are, of course, cooperating with that study and the GAO auditors have been at the CFTC, going over our large trader reports at length.

We want to cooperate and make sure that that is an extensive and thorough study. There are a number of initiatives in the cattle area.

Senator BURDICK. Senator Grassley.

UNDERSTANDING FUTURES MARKETS

Senator GRASSLEY. Thank you. I am not sure my question is different or would require a much different answer than you just gave for this last question. I would like to phrase the question just a little bit differently, and then ask you if it would maybe beg a little different answer.

The general issue just discussed would remind me a lot of town meetings I have had in my state, and I am sure this would be true of most everybody from rural America, where there tends to always be somebody in the audience that brings up the question—it may be posed like this: Shouldn't we just do away with futures trading? Or some question that would imply probably that that person doesn't use it and maybe doesn't understand the purpose of futures trading, and that is not my implication, saying that there can't be things wrong that need to be corrected.

It is kind of a public relations problem for the futures trading industry, itself, that any farmer in the United States would be asking about the role of it, and that is not really your problem if they have a public relations problem, because they need to solve that problem. But where it might fit into your overall operation is this, that the Commodity Futures Trading Association was set up to police, but also to give credibility to an industry in the sense that if it is policed accurately, and perceived to be honest and above-board and not cornering markets, and having people adversely profitting by it, then to some extent maybe it says that the Commodities Futures Trading Commission may not be doing its job in the sense that out there in the grassroots there are people asking questions about—is everything honest and above-board, and should the whole industry be abolished?

My question is, basically, do you see that as a problem? If you see it as a problem, how do you address it as a Commission, as opposed to the industry's responsibility to address what basically is a problem that they are a part of, as well.

Ms. Phillips. You have touched on a number of points, and that is certainly coming at it from the point of view of a number of people who we do hear from on a day-by-day basis. I think your points are absolutely well taken. On the one hand, there are a lot of folks who may not understand the futures markets and what happens sometimes when their cattle are ready to go to auction, they load them up and take them and they have to sell them right then. They can't wait a few days.

Now, if the markets happen to be down on that particular day, often the auction sales are based off of the futures market, so if they don't get a good price that day, there is the concern that it is the futures market that is causing it.

I do hear that and I do understand it. I think in some instances, it is a situation of not understanding the markets. But in like manner, it is also a question of CFTC trying to engage actively in the educational efforts and in making our enforcement activities as public as possible.

Now that gives us some problems because we are required to keep certain information confidential. Nevertheless, we did, following the whole-herd dairy buy-out incident, as a matter of fact, launch an inquiry. There were allegations at that time of perceived manipulation of the market, and were the big players the ones who were moving the market.

We did launch that inquiry and we made those results available to the cattle organizations and the American Farm Bureau, for example. So we have tried to meet with the groups in order that they understand what it is we are doing.

Quite frankly, if prices are down, the futures market is the messenger. Our job is to make sure that the futures prices reflect accurately what is going on in the cash market. So if prices are down, there are going to be some unhappy people, and unfortunately, I can't promise to make everybody happy, or confident, necessarily. But what we can do is try to explain and publicize more carefully what our programs are and what it is we do so that if people are concerned they know what it is that is being done.

Nevertheless, there are some educational efforts that we can participate in, but the exchanges do have to take the lead in that area, I believe.

EDUCATIONAL PROGRAMS

Senator GRASSLEY. Do you participate in some of those educational forums?

Ms. PHILLIPS. Yes, sir; we do. Clearly our firstline responsibility is as an enforcement agency, and we are a regulatory agency. We are not the people who are marketing these instruments. That is not our job.

What we have tried to do, however, is to facilitate the USDA, in particular, in its educational programs. To the extent that there have been extension programs that address futures, we have had people participate in those programs and we have had our people teach the Extension Service people and we have written brochures and so on.

We try to tap in on existing educational forums.

Senator GRASSLEY. Do you have any part of your staff organization that is oriented with that being a major function?

Ms. PHILLIPS. We do have an office of communication and education services. Yes, we do. It is not a large office, and quite frankly, I mean, budget constraints being what they are, we have not been able to expand that office. However, we are doing what we can with our resources.

Senator GRASSLEY. Do you see it as a responsibility for your enforcement agency to encourage the industry itself to do more in public understanding and public education, and if you do, do you do that, and then, third, what has been the response from the industry?

Ms. PHILLIPS. I do see that as one of our responsibilities, and we have urged the exchanges, both privately in my jawboning efforts, and also publicly, to improve their relations with the producer community. And in fact, several of the exchanges have set up their own advisory committees, and have taken to the road to work with the producer groups.

We also have an Agricultural Advisory Committee to the CFTC that is chaired by Commissioner Kalo Hineman. That committee has representatives on it of all of the major general agricultural groups, as well as a number of the producer groups, including the National Cattlemen's Association.

That committee, in addition to their giving advice to us, has turned out to be a forum by which they can go back to their groups and report on the activities of the Commission and we have, in fact, written some of the articles for some of their publications.

But our goal, again, is to educate generally; it is not to promote the markets. I have been very adamant that we not cross that line.

INDUSTRY EDUCATIONAL ROLE

Senator GRASSLEY. The extent to which you urge the industry to pursue more education, that doesn't have to imply that you are trying to promote the industry. That is not implicit in my question to you at all. If that was misunderstood, I want to correct that now. I am only thinking in terms of having a true understanding for farmers who want to make sure of it, as opposed to farmers who don't want to make use of it. That is an individual choice.

But it seems to me like either it is a legitimate function and a part of agriculture, and it needs to be preserved, and the extent to which it is, then people who don't understand it—it seems to me that you would accomplish two things: One, you mute criticism if it is not justified; and, two, in the process you might encourage a broader use of it, and the extent to which it stretches out the marketing year, I think that is important for all of agriculture.

Ms. PHILLIPS. I certainly agree with you and I appreciate your encouraging us in this direction. I come from the educational community, and education is a never-ending process. We will continue our efforts in this area.

I think the exchanges have been responsive; however, there is always more that can be done. I would mention that the 1985 farm bill also included in it a proposal for a marketing program and a 40-county pilot program by which producers could learn to utilize the futures and options market.

We were given specific authority to work with and direction to work with USDA on this and participate in the educational program. There will be a seminar, in fact, next month kicking this effort off.

So we are actively engaged with USDA on education with respect to futures and options markets.

Senator GRASSLEY. Thank you, and thank you, Mr. Chairman.

Ms. PHILLIPS. Thank you, Senator Grassley.

SUBMITTED QUESTIONS

Senator BURDICK. Thank you. I have additional questions to be submitted in writing, as well as several from Senators Cochran and Domenici.

[The following questions were not asked at the hearing but were submitted for response for the record:]

QUESTIONS SUBMITTED BY SENATOR BURDICK

Proceedings and Office of Legal Counsel

Question. The Fiscal Year 1988 budget request does not include additional resources for Legal Counsel; however, it is expected that enforcement litigation and advisory work conducted by this office will increase. Why does the Commission permit a continuation of the strain on resources in the Office of Legal Counsel, rather than seeking additional funding and personnel?

Answer. In recent years, Legal Counsel has been quite successful in defending appeals from Commission injunctive actions, petitions for review of Commission enforcement orders, and collateral attacks on Commission enforcement proceedings, even though its staffing level has remained relatively constant. If, however, Legal Counsel's litigation caseload and advisory work continues to increase, as would be likely with stepped-up enforcement activity, we might seek an increase in Legal Counsel staffing in future years.

Question. In recent years, the amount of litigation handled by the Office of Legal Counsel has sharply increased. Please tell the Committee what types of cases this litigation has involved.

Answer. The greatest increase in Legal Counsel litigation have occurred in the following three areas: petitions for review of Commission reparations decisions, petitions for review of Commission enforcement orders, and administrative Freedom of Information Act appeals.

Cattle Futures Markets

Question. The allegation has been made that cattle futures manipulate the market for producers and that they are used by speculators to the detriment of producers.

What do you make of this allegation?

Answer. The Commission has conducted several studies of the live cattle futures market in recent years in addition to reviewing that contract frequently at weekly market surveillance briefings. None of this review and study has led the Commission to conclude that the cattle futures market is being manipulated or that it operates to the detriment of cattle producers. In fact, cattle feeders and feed lot operators are the largest individual traders of that contract.

Following the whole-herd dairy buyout program announcement of last spring, Commission staff conducted a special inquiry into cattle futures traders' activities and into the supply and demand factors affecting cattle and beef cash markets surrounding that announcement. Results of that inquiry were reported in a Congressional hearing held May 14, 1986. In that testimony, a detailed analysis revealed that several supply factors in addition to the dairy buyout program led to the cash and futures cattle prices manifest at that time.

In addition, the Commission issues monthly Commitments of Traders reports which show that live cattle futures are broadly used, with the majority of contracts held by small, nonreporting traders. Since the dairy herd buyout program of last spring, the Commission has also been publishing monthly cattle advisories showing the four largest commercial and speculative positions in the cattle futures market. These advisories are intended to clarify misconceptions about what types of traders hold the largest positions in these markets. Consistently, the advisories have shown that the four largest long and short positions are held by commercial traders and that those commercial positions are considerably larger than the four largest speculative positions.

Recently a special call was made to futures commission merchants to learn more about small, nonreporting traders in live cattle, feeder cattle, and hog futures as well as live cattle and hog options on futures. We presently have little information on these small traders, who hold the majority of live cattle futures contracts, although there are undoubtedly a number of small commercials in the group of small traders.

Question. At its January meeting, the National Cattlemen's Association announced that it has formed a task force to improve cattle futures contracts including producers and representatives from other interested organizations.

Are you aware of the activities of task force and whether any progress has been made toward improving cattle futures contracts?

Answer. The Commission, particularly through the Office of Commissioner Kalo Hineman, has been keeping in close contact with that task force. On April 2, 1987, the task force plans to spend a half-day at the Commission's headquarters meeting with the Commissioners and senior staff and learning about our regulatory programs. We expect them to ask a number of questions. We will offer to provide all available non-confidential information to the task force and are prepared to meet with them again if they have additional questions for us.

Financial Audit and Review

Question. The Commission's budget request notes that oversight work will be performed at self-regulatory organizations through a continuation of an ongoing schedule of oversight review activities. Thus, six financial rule reviews are planned.

In addition, the budget notes that this plan does not take into consideration the occurrence of financial emergency situations that might require immediate attention of staff.

How will staff be detailed to reviews if such an emergency were to arise? Would additional funding be required?

Answer. The Commission's financial surveillance and audit programs are designed to prevent financial emergencies from occurring by reason of an FCM's failure to meet its financial obligations. Therefore, such emergencies arise from unusual circumstances and, when they do occur, they occur infrequently. The Commission's Division of Trading and Markets has written procedures which outline responses to a financial emergency. Briefly, these procedures include development of the facts involved, coordination of efforts by NFA and the exchanges, keeping the Commission fully advised of the situation on an ongoing basis, and a development of recommendations to the Commission if action by the Division of Enforcement or the Commission is required.

A Commission staff team is detailed from existing units in the Financial Audit and Customer Protection Section of the Division of Trading and Markets to handle such emergencies. Because of the infrequency of financial emergencies the temporary detailing of staff from routine oversight activities has not required additional funding. Should circumstances change and the incidence of financial emergencies which cannot be handled wholly or partially by self-regulatory organizations increase dramatically, the Commission may consider requesting additional resources.

Registration

Question. What is the estimate of applications for leverage transaction merchants and associates that the Commission will review in fiscal year 1988?

Answer. Assuming the current moratoria on new entrants in the leverage industry remains in effect during fiscal year 1988, the Commission will review only the renewal applications of the three presently registered leverage transaction merchants. The Commission also anticipates that it will review approximately 300 applications for registration as an associated person of a leverage transaction merchant.

Question. What is the estimate of floor broker ~~broker~~ applicants the Commission will review in fiscal year 1988?

Answer. In August 1986, the Commission authorized the National Futures Association to process and, where appropriate, grant applications for registration with the Commission as a floor broker. As a general matter, therefore, the Commission will not be reviewing any floor broker applications in fiscal year 1988. However, if NFA believes that a floor broker applicant may be subject to a statutory disqualification from registration, NFA will forward that application to the Commission for appropriate action. The Commission would expect to receive approximately 30 such referrals in fiscal year 1988.

Question. Do you expect the number of requests for exemptions from registration requirements to increase or remain constant in the next fiscal year?

Answer. The Commission expects the number of such requests to remain relatively constant.

Question. Is the allocation of two and one-half staff years sufficient for overseeing National Futures Association operations and procedures to assure compliance with federal registration regulations?

Answer. In transferring its registration functions to the National Futures Association, the Commission worked very closely with NFA, explaining the Commission's own procedures and reviewing the procedures NFA itself intended to establish. As a result, the Commission has confidence in NFA's ability to comply with federal registration regulations. Moreover, based upon its experience in two audits of the NFA registration program conducted since the bulk of the Commission's registration functions were transferred in 1984, the Commission believes two and one-half staff years should be sufficient.

Market Surveillance, Analysis and Research

Question. The Commission's fiscal year 1988 request includes increases in market surveillance subprograms, operating expenses, and costs relating to the addition of personnel. Please provide the Committee with a breakdown of the estimated costs for these activities.

Answer. An increase of $323,000 is requested for the market surveillance program. The requested increase includes $94,000 to cover the cost of two additional staff years and $229,000 for the subprogram's estimated share of the Commission's increase in operating expenses in FY 1988.

Question. The Commission has worked to implement an automated surveillance information system to assist in monitoring and analyzing market activity.

At what stage of development is the automated surveillance system currently?

Answer. The Commission has undertaken two interrelated tasks to more fully automate its surveillance system. The first involved the creation of a new surveillance system in a database environment to support the regulation of instruments such as exchange options which were first traded in 1982. The second goal was to convert existing futures surveillance systems from a batch processing environment to an online database system and to provide integrated options and futures information. The integrated futures/options surveillance system consists of subsystems each having routines to accomplish receipt, editing and update of data; report generation; and online screen displays of positions and transactions of industry members and individual traders. With the exception of two subsystems, the online surveillance system is now in place available to surveillance economists on demand. One subsystem relating to option positions of large traders is currently undergoing tests prior to full implementation and the other relating to futures positions of large traders is in the process of being converted to the data base environment. In addition, data input to virtually all systems has been automated.

When these subsystems are completed, attention will focus on functions economists now perform daily that could be automated. This will be done by studying the routine tasks of these economists and building systems to duplicate those procedures. We also intend to improve our interface with exchanges by providing software and telecommunications hardware capabilities to allow them to directly transmit data as we have allowed FCMs to do.

Question. What enhancements will be necessary for the tracking system to keep pace with the increasing volume of futures and options trading?

Answer. The growth in trading volume will result in submission of more data to be read, sorted and copied to the various parts of the integrated database system. The millions of transactions received daily by the Commission add up to hours of processing now performed mostly overnight. However, timeliness is a major requirement for effective surveillance. To meet these requirements, a computer that can process the transactions more rapidly will be needed. Both the growth in transactions and the increased functions being added to the process to support the systems under development have been included in the capacity sizing study in our 1985 Five-Year Strategic Plan for ADP and Data Communications. A faster processor will be installed to replace the current IBM 4381 Model P13 in FY 1988. This processor was contracted for as the result of a competitive procurement conducted in FY 1986.

More terminals and telecommunications equipment will be needed for the economists and statisticians to track more contracts.

More disk storage capacity for larger volumes of current data to be available to the online system and more tape capacity to store archival data for conducting long term studies of trading will be needed.

Question. What will be the cost of these enhancement in fiscal year 1988?

Answer. The upgrade of the IBM 4381 from Model P13 to Model Q14 will cost approximately $150,000; maintenance for this new central processing unit for the part of the year it will be installed is estimated to be $15,000. New disk storage devices will cost an estimated $180,000. New tape units will be requested in a subsequent year.

Telecommunications enhancements to allow exchanges to directly transmit data is expected to cost $8,000. There will be installation charges as well as charges to add ports and telephone lines to the computer to receive the data. Software contractor support will be necessary to build processing mechanisms to receive, sort and distribute the data and to keep one exchange from reading another exchange's data; this contractor support is estimated to be $120,000.

Question. If a market surveillance economist detects possible disruptions or irregularities in trading, how does he relay this information for follow-up investigation by enforcement staff?

Answer. The market surveillance staff continually is monitoring all active futures and option markets for evidence of price manipulation, delivery congestion or speculative limit violations. Through the surveillance program the Commission attempts to prevent a manipulation before artificial prices are created and a market is disrupted. However, when potential violations of the Commodity Exchange Act ~~or~~ or exchange rules are discovered, the surveillance staff prepares referrals to the Commission's Division of Enforcement or to the appropriate exchange.

Question. What is the timeframe for such activities?

Answer. Straightforward potential rule violations are referred to the Division of Enforcement within a week or so of their discovery, depending on the time required to gather the information needed to demonstrate the rule violation in question and draft a referral memorandum. However, in some cases, where the apparent violation requires some fact-finding and analysis to determine whether there is probable cause that a violation occurred and whether there appears to be evidence supporting that finding, it would take a longer period of time to prepare a thorough referral. If, of course, an ongoing violation is occurring that requires immediate action by the Enforcement staff, the process is expedited appropriately.

Question. The Commission's estimate of market surveillance performance in Fiscal Year 1988 includes the following:

- An increase of 150 in weekly surveillance sheets prepared;
- An increase of 800,000 reports from traders and brokers processed;
- An increase of 5,000 reports checked for compliance with speculative limits;
- An increase of 100 compliance letters;
- An increase of 900 permanent records tables reports; and
- An increase of 150 reports published.

Will the requested additional appropriations cover all of these activities or are these estimates optimistic?

Answer. We do have a rapidly increasing market surveillance workload due to the continued growth of futures and option markets and the new regulatory issues that have arisen from financial futures markets. Nevertheless, we also are aware that in the current budget climate we cannot expect a rapid, corresponding increase in the Commission's budget. Accordingly, we have been modifying our procedures and increasingly utilizing computer capabilities to maintain an effective surveillance program with modest staff increases. We do believe the workload estimates we provided are realistic and can be accomplished with the requested resources and the increased automation of the surveillance process that currently is planned.

Question. How will your automated surveillance system assist in this work?

Answer. Automation can enable our staff to handle effectively most of the increased workload cited above. We have a number of automated systems that are about ready to go into production and others that should be in place by FY 1988 to accommodate the increased volume of reports received as well as those produced by our staff. For example, we are planning to automate the preparation of the surveillance sheets, which currently are summary reports that are prepared manually by our economists from information drawn from about six different sources for each commodity. We already have a pilot program to do that for some markets, and we plan to extend it to all markets next year.

Market Research

Question. The Food Security Act of 1985 required that the Commission establish an options pilot program.

What is the status of this project?

When will it be completed?

Will funds be allocated to this project in FY 1987?

If so, what amount?

Answer. The Food Security Act of 1985 required the U.S. Department of Agriculture to conduct a study of the use of agricultural futures and options by producers in conjunction with agricultural support programs and to conduct the associated futures and options pilot program.

In accordance with the enabling legislation's language, the Economic Research Service of the USDA has requested the services of the CFTC in support of a symposium studying (1) the potential use of commodity futures and option markets by producers to provide price stability and income protection; (2) the extent of the price stability and income protection that producers may reasonably expect to receive; and (3) the federal budgetary impact of such participation in futures and option markets by producers. Commission staff participated in the planning of this symposium, scheduled for May 27 and 28, 1987, and the Commission as well as its staff are represented on the program.

The Secretary of Agriculture is required to report to Congress by December 31, 1988 the results of a USDA study of the three topics mentioned above. In connection with that study, the Secretary of Agriculture has been directed to conduct a pilot program in selected commodities in at least 40 counties designed so that producers may use the futures and option markets to protect and maximize their return on agricultural commodities. Funds for this program will come from the operations of the Commodity Credit Corporation.

The CFTC role in the pilot program, as provided in the legislation, is to cooperate with the Secretary of Agriculture in the conduct of an extensive educational program on the use of futures and options for producers in the counties selected for the program.

The status of the pilot program is one of active development by the Agricultural Stabilization and Conservation Service. At this time, the pilot program has not been implemented, and we are not aware that a firm completion date has been selected by ASCS and the Secretary of Agriculture.

Since the pilot program will be implemented with CCC funds, the CFTC has not allocated specific funds to this project in FY 1988. The impact on CFTC operations will come from staff support of the educational activities associated with the pilot program.

Market Analysis

Question. The Commission estimates an increase of $108,000 is required for market analysis to support economic reviews of proposed futures and options contacts in fiscal year 1988.

Do you expect the volume of contracts submitted for review to increase in fiscal year 1988?

Answer. The Commission expects the number of new contracts submitted in fiscal year 1988 to be consistent with the number submitted in prior fiscal years. The rate of submission of new futures and option contracts is expected to remain high in view of the exchanges' continuing interest in developing new contracts, particularly with respect to financial instruments, such as foreign debt and equity-related indices and currency indices. Also, additional option applications are expected as a result of the termination of the option pilot programs and the introduction of new futures contracts.

Question. What do you estimate will be the volume requiring review as compared to fiscal year 1987?

Answer. The Commission estimates that the staff will review up to 38 new futures and option contracts in fiscal year 1988, the same number it expects to review in fiscal year 1987. The new contracts to be reviewed in fiscal year 1988 are expected to include a number of complex and innovative proposals which will require significant staff resources.

Question. Your budget justification states that staff expects to receive 90 rule changes during fiscal year 1988.

What type of rule changes are anticipated and what review procedures will be required?

Answer. Rule changes submitted in fiscal year 1988 are expected to include a number of proposals which would substantively amend existing contracts' terms and conditions. Such proposals are expected for both financial and non-financial futures and option contracts. The impetus for such revisions stems from exchanges' attempts to update outmoded contract terms to bring the contracts into compliance with changing cash market practices. Also, rule change proposals are expected as exchanges continue to devise alternative terms and conditions, such as the adoption of cash settlement procedures for contracts currently providing for physical delivery. The Commission will carefully review all such proposals to ensure that the revised terms and conditions mirror cash market practices and that the amended contracts would not be susceptible to price manipulation or distortion.

Contract Markets and Registered Futures Association

Question. Has the National Futures Association met its statutory mandate as a self-regulatory organization?

Answer. As you know, the Act requires NFA to establish rules and audit procedures in several areas, such as the financial and sales practice areas. The Act also specifies that NFA must have a mechanism for the arbitration of customers' claims and for the disciplining of those members who may violated NFA's rules. The Commission generally has found that NFA has an effective program in each of these areas, but we continue to oversee their performance, just as we oversee the exchanges' rule enforcement programs.

Question. Please explain those responsibilities that the National Futures Association will assume and how these will affect the Commission's budget in fiscal year 1988[.] (For example, with respect to the review of disclosure documents and floor broker processing responsibilities.)

Answer. The Commission already has transferred to NFA many of its direct regulatory functions with respect to persons marketing commodity futures and options or giving related advice. For example, NFA now handles virtually all of our registration processing responsibilities, including floor broker applications. The only registration tasks that we have retained involve leverage transaction merchants and their associated persons and the taking of adverse registration action against floor brokers. The reasons for these exceptions are that none of these categories of registrants are NFA members.

Over the last few years, we also have shifted to NFA the front-line responsibility for the financial audits of non-exchange member FCMs and the sales practice auditing of the entire industry. We expend substantial resources monitoring the effectiveness of NFA's program in these areas, but these resources are much more effectively deployed in our present oversight posture than they were when we had the initial audit responsibility.

As a result, about the only identifiable remaining direct sales practice audit task is the review of the disclosure documents that must be filed with the Commission by commodity pool operators and commodity trading advisors. In FY 1986, the Front Office Audit Unit reviewed 1600 of these documents. We would expect to transfer gradually this responsibility to NFA, so that we will be reviewing approximately 200 documents in FY 1988. I should emphasize that the limited retention of this review by the Commission staff does not overlap NFA's own review because it serves different purposes. First, this review aids our continual monitoring of the effectiveness of NFA's sales practice review program for commodity pool operators and commodity trading advisors. Second, such review keeps the Commission aware of changes and developments in the industry.

Question. How does the Commission conduct follow-up reviews of the effectiveness of self-regulation in the exchanges? What is the level of market surveillance conducted?

Answer. Commission staff routinely conduct audits, or rule enforcement reviews, of exchange market surveillance, trade practice surveillance and disciplinary programs in order to assess the sufficiency of a contract market's self-regulatory efforts in these areas. Commission staff also perform audits of exchange sales practice and financial audit compliance programs. In each area, a focus of the Commission's rule enforcement review program has been to conduct formal follow-up reviews of exchange self-regulatory programs to assure that exchanges remedy previously identified deficiencies and maintain previously noted strengths. Generally, these follow-up reviews are conducted six months to one year following issuance of the full-scope review and, similar to full-scope review, result in a publicly-available report. With regard to market surveillance specifically, in both full-scope and follow-up reviews, Commission staff evaluates whether an exchange's program is adequate to detect indications of possible market congestion or other market situations which could result in possible price distortion. Commission staff examines exchange programs for monitoring traders with reportable positions, and enforcement of their speculative limit rules, concentrations of positions among traders and clearing members, price movements, volume and open interest, and deliverable supplies.

Question. The Commission estimates that requested funds will maintain the current level of oversight in fiscal year 1988.

Considering the large increase in trading anticipated, will these funds be sufficient?

Answer. The funds requested for FY 1988 for the Contract Markets and Registered Futures Association Section of the Commission's Division of Trading and Markets should be sufficient, notwithstanding anticipated increases in trading. In this program area the Commission has for several years been increasing its emphasis on oversight of exchange and National Futures Association activity so as to maximize the use of Commission resources. The Commission has worked with these self-regulatory organizations to assure their implementation of effective programs to monitor the markets, bring disciplinary actions in appropriate cases, and to conduct direct audits of registrants. Thus the budgets, staffs, and substantive scope of these self-regulatory programs have increased substantially in recent years. Of particular note, most exchanges have developed sophisticated computer-assisted trade and market surveillance systems. Those systems will be enhanced further as a result of the input of one-minute trade timing data obtained in compliance with the Commission's audit trail amendments to Regulation 1.35(g). Given these important developments plus the recent development of a computer database by Commission staff to assist in Commission review of trading, the Commission expects the requested level will enable it to meet the challenges posed by increased trading volume.

Question. Is self-regulation helping to curtail federal costs?

Answer. As discussed in detail in response to the prior question, the trading and market surveillance, disciplinary, and audit programs executed by self-regulatory organizations have permitted the Commission to achieve its regulatory objectives in these areas with less staff than otherwise would be necessary. Accordingly, self-regulation is helping to curtail federal costs.

Front Office Audit

Question. The Fiscal Year 1988 budget request estimates an increase of $64,000 for the Commission's Front Office Audit subprogram.

Considering the implementation of the new industry-wide sales practice audit, as well as the increasing number and type of designated futures and options contracts that will require oversight, won't additional resources be required for the Front Office Audit?

Answer. The Commission's Front Office Audit subprogram has been organized and staffed to act in an oversight capacity to industry self-regulatory organizations, the exchanges and NFA. The Front Office Audit Unit of the Division of Trading and Markets monitors self-regulatory sales practice audit programs and issues rule enforcement reviews reporting on such programs to the Commission on a regular cycle. As of September 30, 1986, twenty-two such reports were provided to the Commission. As a result of these efforts there is an effective SRO sales practice audit program operating in the industry. The increase in the number of contracts may require refinements to existing programs but not major changes. In view of the fact that existing programs are in place and because, in part, SRO's have cooperated in implementing necessary improvements in existing programs, the Commission's program will not require any additional staff. The $64,000 increase which is discussed on page 63 of the Explanatory Notes is a pro rata share of the Commission's anticipated increase in operating expenses for fiscal year 1988 which is allocated to the Front Office Audit subprogram.

QUESTIONS SUBMITTED BY SENATOR COCHRAN

Dual Trading

Question. When people talk about the futures markets, frequently they refer to the phenomenon of dual trading whereby brokers in the pits may trade for their own account while also trading for a customer. As I understand it, dual trading is not a crime and indeed provides many benefits to the market.

The problems with dual trading occurs when a broker trades ahead of his customer, in effect "stealing" a better price from his customer. I presume that most brokers are honest and that abuses do not commonly occur. Have you done any studies, or have you read any studies, that estimate how prevalent this abuse might be? Have you adopted any programs to combat this situation?

Answer. We do not believe that this abuse is prevalent, although it was difficult using the audit trail information formerly available to quantify the degree to which brokers trade ahead of their customers' orders. Nonetheless, the Commission has taken steps to combat this and other types of trading abuses. The Commission's adoption of rules requiring exchanges to time each trade to the minute will permit each self-regulatory organization to more easily detect and prosecute possible trading abuses. This is particularly true in cases involving trading ahead, where more precise timing data are critical to establishing guilt or innocence. In addition, the Commission, through its rule enforcement review oversight program, has urged the exchange community over the past few years to upgrade their computerized surveillance capabilities and generally to increase the level of sanctions imposed for trading abuses. The exchanges have responded affirmatively to these recommendations. Finally, the Commission's own oversight function has recently been enhanced by the development of an exchange database program which will allow Commission investigators to monitor more effectively the markets for trading ahead and other trading abuses. As a result of these improvements the Commission's and the exchanges' ability to detect, deter, and prove trading ahead violations has been, and will continue to be, improved.

Foreign Futures and Options

Question. I understand the Commission is now engaged in the rulemaking concerning appropriate regulations for the offer and sale of foreign futures and options contracts in the United States. Would you describe for us the regulations now applicable to the retailing of foreign futures and options in the United States?

Secondly, would you describe for us the proposed enhancements that you would make in this regulatory scheme? Would you also comment on whether this proposed enhancement will provide regulation of foreign products that is as stringent, if not more stringent, than the existing regulations for domestic instruments?

Answer. Under the existing regulatory scheme, the domestic offer and sale of foreign futures is regulated only through an anti-fraud rule. Thus, the protection offered to customers trading on domestic futures exchanges through the registration, segregation and recordkeeping requirements of the Act and regulations are not provided to domestic customers of foreign futures products. In contrast, the domestic offer and sale of foreign options is generally prohibited, subject to a limited commercial exemption.

With certain exceptions, the proposed regulations governing the offer and sale of foreign futures and options would provide that such transactions must be effected through Commission registrants, or comparably registered entities, under a regulatory framework similar to that governing domestic futures and options. Thus, the Commission's registration, recordkeeping and reporting requirements would be applicable. In addition, customer funds would be required to be segregated while those funds are held in the United States.

Because the Commission has no regulatory authority over foreign exchanges themselves, the proposed regulations to govern the offer and sale of foreign products cannot be as stringent as the existing regulations for domestic products. Moreover, in developing the proposed rules, the Commission took note of the fact that foreign futures have been offered in an essentially unregulated environment for some time with few, if any, customer complaints. Therefore, the Commission sought to impose no significant additional burdens on existing Commission registrants, while generally assuring parity between those persons soliciting and accepting foreign futures and options customers and those persons who are currently registered with the Commission.

The proposed rules deal with a number of complex issues, and the comments received from the United States futures industry were by no means uniform. The Commission intends to give careful consideration to each of the comments and will make every effort to accommodate the concerns of the commenters as it moves toward the development of final rules.

Off-Exchange Transactions

Question. I understand that you are conducting a study of non-exchange traded financial instruments. I would be interested in your views concerning how prevalent these instruments are today, and how you plan to deal with any non-exchange traded futures or options contracts that you uncover during your study.

What is the status of this study? Will your requested increase in enforcement resources be applied to this area?

Answer. The Commission has become aware of a number of off-exchange commodity instruments developed over the past year or so, and is of the belief that a careful look at the extent of these developments is warranted so that informed decisions can be made. For this reason, the Commission in February of this year approved the formation of an inter-divisional staff task force to conduct a broad examination of off-exchange transactions. This examination will include analysis of such instruments, and bank-funded commodity related instruments. The task force is to study, and if appropriate, recommend possible regulatory initiatives or congressional action in this area. The Commission expects a detailed outline of the task force's inquiry by early summer.

Our requested increase in appropriations for fiscal year 1988 was based on our assessment of our enforcement needs in general, including rendering assistance to state authorities in the prosecution of off-exchange commodity fraud. This request predated the formation of the task force. It is always possible that the task force itself may uncover information about programs being offered to the public that are in fact unlawful commodity options or futures contracts. Should this occur, the Commission would, of course, be prepared to utilize its enforcement resources in this area, as appropriate.

Speculative Limits

Question. Madam Chairman, I know that you share my view that, generally, self-regulation of the marketplace is the best regulator of commercial activity. Given that philosophy, could you explain the historic justification for speculative position limits and indicate whether you think some reforms are appropriate to increase speculative limits in today's agricultural and financial markets.

Answer. Section 4a of the Commodity Exchange Act contains the Congressional finding that excessive speculation is a burden on interstate commerce and provides that the speculative limits shall be established by the Commission to diminish or prevent that burden. Pursuant to this section, Commission rules specify limits for certain agricultural commodities such as grains and soybeans while the limits for all other commodities are specified in Exchange rules which have been reviewed and approved by the Commission. Under amendments to Section 4a which were made in 1982 it is a violation of the Commodity Exchange Act if a trader exceeds any exchange limit which has been approved by the Commission.

The Commission's policy on speculative limits is intended to result in speculative limits which are reflective of total trading volume, deliverable supply and supply capabilities, and normal speculative activity in a particular market. Limits should be high enough to assure adequate liquidity but should protect the market from disruption by unusually large positions and facilitate orderly expirations. If the limits become restrictive, they can be raised. This applies to both exchange limits and those established by the Commission.

In connection with its recent review of its agricultural limits the Commission has proposed doubling or tripling certain limits on a contract-by-contract basis in view of the overall larger size of certain markets in recent years and the potential restriction on a few of the larger traders. Certain markets which draw on exactly the same deliverable supply are proposed to have positions aggregated, resulting in some reductions in spot month speculative positions. These proposed changes, among others, are the result of a complete review of the agricultural speculative limits contained in Commission rules. Following a review of public comments received on the proposed rules, the Commission will commence fashioning final rules revising speculative limits on agricultural commodities. However, beyond such a periodic, thorough review of the exchanges' and CFTC's limits to assure they meet this overall philosophy, the Commission sees no further need for reform or revision. The Commission has adequate authority to revise federal speculative limits following the notice and comment procedures required by the Administrative Procedure Act. Separately, exchanges can, of course, petition for changes in their Federal speculative limits or propose amendments to their own rules in the case of exchange limits.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

Biennial Budget Cycle

Question. Calls for budget reform are increasingly heard as budget deadlines are too often missed, important budget decisions are delayed, appropriation bills and other direct spending legislation are held up in committee, and omnibus spending bills take the place of timely and orderly consideration of individual bills. One procedural reform that is being considered is the two-year budget cycle where budget and appropriations and oversight would be undertaken in the second year.

Would your department/agency favor a biennial budget process? What benefits would your agency achieve in a two-year appropriation cycle?

Answer. Ideally, an agency needs to know its budget level three to four months before the beginning of the new fiscal year in order to plan to use its appropriations effectively. Under the current system, often the agency does not know its budget until two or three months into the fiscal year. As a result, the agency operates in limbo for several months, often at levels which are lower than the eventual appropriation. Because most of the agency's costs are in personnel and other fixed costs, hiring and other cutbacks, such as travel, may occur because these types of expenditures may need to be reduced to compensate for fixed cost increases, such as rent, which the new budget was intended to cover. In addition, the agency cannot plan purchases in a manner which makes expenditures during the four quarters of the year relatively equal.

There are pros and cons of operating on a two-year cycle. On the positive side, noticeable time would be saved by only going through the cycle of preparing budget requests, meeting with OMB, participating in Congressional hearings, etc., every other year. At least one year out of two, the agency would be assured of sufficient time to plan for the next fiscal year. On the other hand, however, it would be difficult to predict budget needs so far in advance. As it stands now, the agency develops its budget 18 months before the start of the new fiscal year, making it difficult to respond to changes in costs which occur between the formulation stage and implementation. For example, CFTC is reauthorized every few years, and it is difficult to predict whether reauthorization will place new burdens on the Commission's resources. In addition, market crises, which are always unanticipated, may result in a need for additional resources which would have to be put off until the next two-year budget cycle.

All of these problems in predicting and covering changes in resources under a two-year system could result in an increased need to seek supplemental appropriations. If the process of seeking supplementals became burdensome, the positive effects of the two-year cycle would be negligible.

Question. Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer. The types of costs requested are generally the same from year to year. Most of the agency's budget consists of personnel costs, and most of the remaining costs are fixed costs such as rent and utilities. Other costs change from year to year. Some of these costs, such as the purchase of ADP equipment, can be planned, while others are more difficult to anticipate since they are responsive to legislative or market changes.

Question. What difficulties can you foresee in preparing and submitting a two-year budget to the Congress?

Answer. As mentioned previously, it may be difficult in some areas to anticipate increases in costs. Some of these increases may be large enough to cause the agency not to be able to operate within the constraints of its two-year plan.

Question. Would you expect to realize any budget savings if you could plan your agency budget on a two-year basis? If so, could you estimate how much?

Answer. Most potential savings would arise from multiyear contracting. The agency already has multiyear leasing authority which does result in savings. I would not anticipate any significant additional savings from the few contracts the Commission has which it might want to extend to two years. In addition, there would be savings of up to $30,000 in staff-time for each year in which no budget request or supplemental were prepared.

Question. If you oppose the biennial budget concept, please give this subcommittee your reasons why.

Answer. The Commission does not oppose the biennial budget concept.

FOOD AND DRUG ADMINISTRATION

STATEMENT OF FRANK E. YOUNG, COMMISSIONER

ACCOMPANIED BY:

JOHN A. NORRIS, DEPUTY COMMISSIONER
THOMAS SCARLETT, CHIEF COUNSEL
SHARON SMITH HOLSTON, ACTING ASSOCIATE COMMISSIONER FOR MANAGEMENT AND OPERATIONS
FRANK P. CLAUNTS, DIRECTOR, DIVISION OF FINANCIAL MANAGEMENT

INTRODUCTION OF WITNESS

Senator BURDICK. We will now hear from the Food and Drug Administration.

Commissioner Frank Young is charged with the management and oversight of an agency that directly affects the lives of all American consumers. Under his direction, our nation's food supply is guarded against contaminants, unsafe levels of additives, chemical residues, and product tampering. Additionally, the FDA assures that human and animal drugs and devices are accurately labeled, safe and effective. During the past year, Commissioner Young has encountered many challenges, from AIDS to Salmonella, in his efforts to protect the American health.

The FDA budget includes a request for increases in programs for fiscal year 1988, totaling $5 million. This sum will enable FDA to enhance its research and review efforts for new drugs and medical devices; for stepped-up activities to counter AIDS; for strengthening food surveillance and emergency activities; and for the development of improved risk assessment criteria used by its scientists.

An additional $9 million is requested for rental payments to GSA necessary to maintain FDA laboratories and field offices. In an effort to offset the total requested increase of $34 million in fiscal year 1988, FDA is proposing legislation that would enable it to collect almost $34 million in user fees from applicants for new drugs or medical devices.

The subcommittee is pleased to welcome Commissioner Young. You may proceed with your testimony, Dr. Young, and summarize it as you wish.

BUDGET FOR THE FOOD AND DRUG ADMINISTRATION

Dr. YOUNG. Thank you. In respect for your time, I would like to briefly introduce the members of the panel, and then just rapidly summarize the testimony and introduce the testimony for the record.

With me today is Mr. Frank Claunts, who is our Budget Officer; Ms. Sharon Holston, who is our Acting Associate Commissioner for Management and Operations; Deputy Commissioner, Mr. John Norris; and General Counsel, Mr. Tom Scarlett.

The Agency is indeed grateful to the administration and the Congress for the support that it has received in the last year.

FDA as you mentioned, Mr. Chairman, in your statement is an agency that is extraordinarily important to the health and well-being of the U.S. public. We are charged with the protection of products representing 25 cents on every dollar that each of us expends, and the oversight of a portion of industry whose sales amount to about $550 billion each year. It is indeed a large challenge.

I would like to focus on a few of the most significant things that FDA has accomplished this year. I will submit for the record a summary of the FDA's significant accomplishments, which have included a focus on the disease AIDS, which is a dreaded disease, with the most rapid approval in the history of FDA of an important drug, which, though not a cure, is a drug that does prolong life. AZT was approved in about 108 days, an approval that occurred just 22 months after clinical testing began.

[The information follows:]

FOOD AND DRUG ADMINISTRATION

SUMMARY OF SIGNIFICANT ACCOMPLISHMENTS AND ACTIVITIES IN FISCAL 1986

EXECUTIVE SUMMARY

SELECTED SIGNIFICANT ACCOMPLISHMENTS OF THE FDA

FISCAL 1986

Consumer protection was brought to the fore in FY 86 by many FDA actions designed to resolve major public health problems. These include but were not limited to: (1) major educational and product approval actions concerning AIDS, (2) removal of harmful compounds from foods that produce allergies and other disorders, (3) a general focus on bringing the fruits of technologic advances to the public, (4) final development of a risk analysis program, and (5) extensive commitment to risk management both in the regulatory arena and in FDA's response to an unprecedented number of tamperings.

FDA's significant accomplishments in FY 86 are summarized in this publication, and selected highlights are summarized below for the reader's convenience.

ACTION PLAN IMPLEMENTATION

- Completed 75 percent of milestones for Action Plan Phase I, with 94 percent of milestones begun.
- Commenced planning for Action Plan Phase II.

RISK MANAGEMENT

- Responded to more than 1,500 reports of product tampering. Tested more than one million Tylenol capsules for cyanide, and examined more than 60,000 jars of baby food for glass fragments.
- Investigated a series of microbiological contaminations, especially in dairy products, and significantly upgraded public health protection in this area.
- Conducted successful investigations into the illegal use of anabolic steroids, the illegal sale of veterinary drugs, and the illegal importation of counterfeit drugs.

NEW PRODUCT REVIEW

- **Approved 30 major new drug and biological chemical entities, including three major advances using biotechnology.**
- **Approved a treatment protocol for approximately 6,000 AIDS patients to receive Azidothymidine (AZT).**
- **Approved over 600 generic drug applications.**
- **Approved a record 72 original premarket approval applications for new medical devices, including two innovative new pacemakers and an automatic implantable defibrillator.**
- **Significantly reduced average review times for investigational device exemptions (IDEs) and for IDE supplements.**

- Reviewed over 90 percent of new animal drug applications within statutory time limits.
- Approved 2,500 medicated feed applications under new "Second Generation" policy.

RULEMAKING

- Banned the use of sulfiting agents on fresh fruits and vegetables (e.g., in salad bars); and required sulfite labeling in packaged foods. Proposed warning labels for prescription drugs.
- Applied de minimis theory to food and color additives, based on risk assessment that additives posed no human health risk.
- Instituted flexible labeling rules for OTC drug products.
- Completed premarket approval regulation for medical devices.

SCIENCE BASE

- Published over 750 articles in the scientific literature.
- Embarked on a major research program in risk assessment to better understand how to extrapolate animal test data to human health.
- Designated as Department lead in developing a government-wide framework for biotechnology policy.

CONSUMER COMMUNICATIONS

- Fielded more than 1,800 press inquiries and set up more than 300 interviews.
- Prepared 53 news releases and 89 talk papers.
- Published 4 issues of FDA Drug Bulletin and 10 issues of the FDA Consumer.
- Presented more than 30 national speeches and two national conferences, each attended by more than 600 people.

INTRODUCTION

In FY 86, the Food and Drug Administration completed an impressive number of significant accomplishments. This was made possible, in many instances, because of the planning and objectives laid out in 1985 under FDA's Action Plan. A document charting a course that will enable the agency to meet the challenges of the next century, the Action Plan grew out of recommendations from within FDA and from more than 50 consumer, trade and professional groups on whom FDA has impact. From this process, FDA's Policy Board, comprised of its senior managers (Appendix A), established a planning program stressing ten important areas:

1) New Drug Review Process;
2) Medical Device Program;
3) Postmarketing Surveillance;
4) Risk Assessment;
5) Risk Management;
6) Food Safety;
7) Nutrition;
8) New Technologies;
9) Health Fraud; and
10) Internal Management.

Devising an Action Plan, however, was only the beginning and constituted only part of the activities of the agency. In order to oversee efforts to meet the challenges posed in these ten areas, FDA put into place an Action Plan Reporting and Evaluation System (APRES). By the end of FY 86, work was underway on at least 94 percent of the milestones laid out under APRES, and 75 percent had been successfully completed. (A set of charts outlining these objectives and accomplishments is attached in Appendix B.) At the request of Commissioner Young, Deputy Commissioner John A. Norris is overseeing implementation of the Action Plan and meets personally with agency managers on a regular basis in order to discuss the plan's progress. APRES is being coordinated by Associate Commissioner for Planning and Evaluation Gerald L. Barkdoll. For the future, FDA intends to build on its successes with action planning, and efforts are underway to develop Action Plan, Phase II.

This document is a summary of the agency's many noteworthy accomplishments under the Action Plan and in related areas. Of course, working on and completing planned initiatives is not the only place where FDA makes important public health contributions. FDA carries out an active research program in support of its public health activities, and in FY 86, Agency scientists published over 750 articles in the scientific literature (a representative listing of the most significant articles published is contained in Appendix C). In FY 86, FDA has also had to respond to an unprecedented number of unanticipated events that can be truly classified as "emergencies." These emergencies included product tamperings, the Chernobyl nuclear accident, and a record number of investigations into contaminated foods. Much of this work by FDA was carried out by the agency's field offices; therefore the accomplishments of the Office of Regulatory Affairs will be discussed first.

OFFICE OF REGULATORY AFFAIRS

The agency's Office of Regulatory Affairs (ORA) is a unique organization within FDA because it is comprised of both headquarters staff and those in 10 regions, 22 district offices and 136 satellite resident posts located across the country and in Puerto Rico. In FY 86, ORA staff participated in seizures involving 241 violative products, oversaw the recall of 3,637 products, and issued 403 regulatory letters. In addition, these offices responded to a record number of emergencies, most notably the product tampering crisis. The tampering outbreak that had occurred earlier in 1982 centered primarily around one product, Tylenol capsules. Although there were complaints of tampering with a few other products as well, the reports decreased rapidly following the promulgation of new tamper-resistant packaging regulations.

In February 1986, history repeated itself when a death in New York was linked to the lacing of Tylenol capsules with cyanide. In contrast to the 1982 experience, however, the complaints of tampering quickly spread to baby food, girl scout cookies, beverages, pudding, peanut butter and other over-the-counter drugs. (A representative list of tamperings and tampering reports is included in the list of field emergencies attached to this report in Appendix D.) The number of reports is staggering. In all of FY 85, FDA received only 128 reports of tampering. By contrast, in FY 86, the number reached more than 1,500. The costs, too, have been significant in terms of diversion of FDA resources. The total cost to FDA of handling these emergencies is well in excess of $22,700,000 and more than the equivalent of 500 person years. It was necessary to divert many resources from normal field activities to meet these emergencies.

In the end, many of the complaints of tampering investigated by FDA field personnel turned out to be unsubstantiated. But in order to know this with certainty and to assure public health protection, FDA needed to act quickly and decisively and in each case to inspect manufacturing plants, collect and analyze product samples, and sometimes assist manufacturers in the withdrawal of products from store shelves locally, regionally, or nationwide. In the case of complaints of glass in baby food, the field staff examined more than 60,000 unopened jars of the product within two months of the first report, but the most FDA found were fragments as small as a grain of salt and no larger than a grain of wheat in only 14 jars, and even these fragments, because they were so small, would be harmless if ingested. These results, inspections of manufacturing facilities, and the firm's history of compliance with FDA's Good Manufacturing Practice regulations for foods, helped to restore confidence to consumers in the safety of these products and to prevent serious economic hardship to this industry.

FDA staff, under the leadership of ORA's Division of Emergency and Epidemiological Operations, are studying the reports of tampering and the agency's handling of these complaints carefully to learn how FDA can best inform consumers, work with industry to solve these problems, and optimize its resource use in such emergencies. In addition, agency officials are working closely with the industry and key trade associations, such as the Proprietary Association and the Grocery Manufacturers of America, in order to achieve prevention of tampering through improved product packaging and consumer education.

Across the country, the investigatory work carried out by FDA's field force also helped to deal with tampering in another way--by assisting the Federal Bureau of Investigation (FBI) and State and local law enforcement authorities in taking legal action against those who committed some of these tampering crimes. Perhaps the most notable case is that of an individual who in May was arrested and charged with putting rat poison in Contac, Teldrin and Dietac capsules and with demanding that the manufacturer remove all of its over-the-counter capsule medications from the market. In August, this individual pled guilty to the charges and on October 30 was sentenced to 27 years in prison.

Product contamination can occur in ways other than tampering of course, and in 1986 FDA's field offices also spent considerable resources in the investigation of illness due to contaminated foods. Following a serious outbreak of

Listeriosis in Southern California in 1985, resulting in at least 40 deaths in vulnerable victims (i.e., pregnant women and their fetuses, frail elderly persons, or those with weakened immune systems), the agency increased its surveillance for the presence of Listeria monocytogenes and other disease-causing microorganisms in dairy plants. This surveillance resulted in inspections of more than 250 processing plants and the collection and analyses of more than 1,100 samples. As a result, seven firms recalled dairy products found to contain the hazardous Listeria organism. These products included ice cream bars, ice cream, soft-ripened cheese and chocolate milk. At the same time, FDA also increased its surveillance of imported soft-ripened cheese products for Listeria. More than 2,000 samples of domestic and imported cheeses were collected and analyzed and 13 distributors conducted product recalls after FDA found Listeria contamination in their products.

ORA's surveillance activities for contaminated products included animal feeds as well. In response to a consumer complaint, FDA learned that heptachlor-contaminated spent grain was being sold to farmers for use as feed for dairy cows. Heptachlor is a pesticide which can accumulate in an animal's body fat and be excreted in milk over a prolonged period of time. Extensive surveillance work was required by the FDA in partnership with the states of Missouri, Kansas, Texas and Oklahoma in order to locate all of the dairy products which may have become contaminated with the pesticide. More than 1,350 samples of milk and milk products were collected and tested, resulting in the quarantine of 56 dairy farms in 3 states, recalls of products by 11 firms, and the destruction of thousands of gallons of contaminated milk.

In April of this year, the world was stunned to learn of the nuclear accident at Chernobyl and officials worldwide immediately focused on the many implications of the accident, including those for public health in the United States. For FDA field offices, this meant activating emergency systems for monitoring domestic and imported food and drugs for contamination with radioactive isotopes. Samples of fish, dairy products, bottled water, cheeses, mushrooms, beverages and other products have been analyzed by ORA's Winchester Engineering and Analytical Center, Winchester, Massachusetts. More than 840 samples were tested for contamination with Iodine-131, Cesium-134, and Cesium-137. No contamination of

U.S. foods was discovered and only a few problems with imported products were found. The sampling program resulted in the detention of several lots of imported foodstuffs and confirmed that the domestic food supply was safe from radioactive contamination.

FDA inspection activities also resulted in other public health gains in 1986. ORA field offices investigated a variety of illegal human and animal drug distribution schemes. In May, FDA, the Department of Justice and the FBI announced the first of what is expected to be a series of indictments involving the illegal use of anabolic steroids and other drugs to enhance athletic performance. Federal prosecutors have filed charges against several individuals and at least one corporation citing the illegal distribution of numerous approved and unapproved drugs including ethylestrenol, fluoxymesterone, methandrostenolone and others, mostly through black market channels. FDA investigators found these channels to include health professionals and persons also involved in the legitimate drug distribution system in the U.S. Thus far, one involved individual has been sentenced to more than four years in prison and another fined $200,000.

A second major ORA field investigation involved the illegal sale of veterinary drugs. In some cases, these investigations revealed the sale of prescription veterinary products without a valid veterinarian/client relationship. In other cases, the drugs themselves had been banned from the market but were still being sold. For example, in July, 1986, FDA initiated a top priority recall to farmers, veterinarians and other users to return supplies of oral chloramphenicol, a drug banned in January. FDA field offices also have increased investigations into the illegal importation and distribution of unapproved bulk drugs going to veterinarians, medicated feed mills and other veterinary product manufacturers. This has resulted in the seizure of illegal bulk antibiotics and other veterinary drugs. With help from the states, FDA is successfully implementing programs to develop veterinary laws and take enforcement actions needed to halt further misuse of veterinary drugs.

Agency field offices this year also improved the FDA program for monitoring the possible illegal importation of counterfeit drugs. In the wake of the discovery of the illegal importation and distribution of counterfeit Ovulen oral contraceptive in 1984, FDA assigned high priority to the investigation of these activities. In 1986, this led to the investigation into and subsequent recalls of counterfeit Pipracil, an antibiotic. ORA also issued an Import Alert to FDA field offices outlining specific guidance regarding the detention, sampling, testing, and clearance of imported pharmaceuticals. In addition,FDA initiated a major review of its "American goods returned" program to enhance its capability to deal with counterfeit and diverted drugs. These actions have served to strengthen agency surveillance against these illegal products.

Concurrent with these many field activities, FDA field laboratories were involved in sample analysis research in support of the regulatory process; and specific scientific methods were developed or used for analysis in situations such as analysis of cyanide in food and drug products, Listeria in dairy products, glass in baby foods, and radionuclides in imported foods. More than 100 articles were published by ORA scientists in the scientific literature. In addition, ORA staff made over 200 presentations at regional, national and international meetings, including presentations on fishery good manufacturing practices and quality at the Sri Lanka Standards Institute and Thailand Fisheries Department, and on virulent Vibrio vulnificus from U.S. estuaries at the Tenth National Congress for Microbiology in Valencia, Spain.

Finally, for the staff of the Office of Regulatory Affairs, 1986 has also been a year of change in leadership. After 30 years of outstanding government service (with 28 of those years in FDA), the Director of ORA, Associate Commissioner for Regulatory Affairs Joseph Paul Hile, retired from government service. Mr. Hile's government career was a long and distinguished one, and among his many achievements he is remembered for leading FDA through the product tampering crises in 1982 and again in 1986. Since his retirement, ORA has continued its work under the able leadership of the new Associate Commissioner of Regulatory Affairs, John Taylor, formerly Director of the ORA Office of Enforcement.

CENTER FOR DRUGS AND BIOLOGICS

In FY 86, the Center for Drugs and Biologics (CDB) vigorously pursued a wide variety of critical public health protection activities. Under FDA's Action Plan, CDB is responsible for product review and postmarketing surveillance activities. CDB also conducted much promising research, published important regulations, and investigated many compliance cases. Nonetheless, CDB's efforts in these areas were often overshadowed by the urgency of its efforts to fight the nation's #1 public health enemy--AIDS. This section will describe CDB's role in fighting AIDs, as well as its product reviews, postmarketing surveillance, research, and rulemaking activities.

In FY 86, the Center mobilized and reallocated its available resources towards facilitating the swift development and approval of any therapy found to be promising for the treatment of AIDS and AIDS-related conditions. Specifically, FDA has assigned all potential AIDs therapies its top priority--a 1-AA designation--during both the investigational new drug (IND) and new drug application (NDA) stages.

This will mean that promising AIDS therapies now receive the absolute top priority in the drug review process. The designation is a natural extension of the 1-A, 1-B, 1-C classification scheme that FDA has used for several years. The 1-AA designation will mean:

- Special Pre-IND Consultation to expedite filing of an IND and to ensure a rapid turnaround once the IND is actually filed;
- Expedited determination of Orphan Drug Status; and
- Expedited NDA Review, with completion in less than 180 days.

The first application of the new 1-AA designation was to the drug azidothymidine (AZT). Preclinical studies conducted in CDB's Division of Virology laboratories and the National Cancer Institute were among the first to indicate AZT's inhibitory effects on the HTLV-III virus, the agent which causes AIDS. In June 1985, FDA approved the first clinical testing of AZT within five days of receiving the application. When early clinical tests were promising, FDA approved the expansion of clinical trials which led, ultimately, in late September 1986, to FDA approval of a treatment protocol for approximately 6,000 AIDS patients. FDA approved this protocol in 7 days. In addition to AZT, other AIDS and AIDS-related drugs already receiving orphan drug status include HPA-23, BW-759U, and pentamidine.

FDA has also been actively safeguarding the nation's blood supply. Once it became evident that AIDS could be transmitted through blood and blood components, it became essential to develop criteria for identifying and excluding prospective blood and plasma donors at increased risk of transmitting the disease; and to develop reliable blood screening tests.

By the fall of 1985, five HTLV-III antibody tests were licensed, the first within 5 days. By the end of FY 86, three more similar tests were also licensed. The universal application of the HTLV-III antibody test to screen all blood and plasma, a test which has now proven to be highly sensitive, has added immensely to our ability to ensure the integrity of our nation's blood supply and to assist our research efforts toward prevention and treatment of AIDS.

CDB has also conducted important research directed towards issues raised by the AIDS epidemic. In the Office of Biologics Research and Review, several laboratory groups have conducted (1) research concerning a variety of topics including the basic immunologic defects associated with the disease, which might contribute to an understanding of how biologics or drug products might combat the virus, and (2) studies of the characteristics of the virus that will likely be important in the development of vaccines and therapeutic agents. In addition, they have assisted in the evaluation of drugs for antiviral effects.

FDA is participating actively on the PHS task force on AIDS that reports directly to the Assistant Secretary for Health. This close collaboration of all PHS agencies in supportive research, providing guidance to the public, and approval of products is the keystone of the effort to conquer this disease.

In addition to AIDS-related activities, improving the new drug review process is FDA's highest priority under its Action Plan. In January 1986, FDA announced that it had approved a record 30 new chemical entities in calendar year

1985. A number of these approvals occurred in the first quarter of FY 86, including the anti-arrhythmic drug Cordarone, the antihypertensive Vasotec, the tranquilizer Cesamet, the new topical anti-inflammatory drug Temovate, and a new aerosol anti-viral called Virazole.

In the summer of 1986, FDA approved three significant products derived through biotechnology, all of which involved major scientific advances. In June, FDA licensed preparations of interferon to treat a rare adult leukemia--hairy cell leukemia--for which there had been no effective therapy. Interferons are chemicals produced in tiny amounts in the human body. Only in the last decade, with the development of gene splicing, have scientists been able to produce the larger amounts of this substance needed to conduct clinical trials to discover its real potential in treating human disease.

Also in June, FDA approved the first therapeutic use for a monoclonal antibody within the human body to reverse acute kidney transplant rejections. Called Orthoclone OKT*3, this pioneer drug is produced by fusing one antibody-producing cell with an ever-reproducing cell resulting in a hybridoma producing a specific and uniform antibody. OKT*3 is active against the body's own T-cells, white blood cells responsible for acute rejections.

The third biotechnology milestone approval involved a genetically engineered vaccine for the prevention of hepatitis B, one of the most serious forms of viral hepatitis. The vaccine, licensed in July, is produced by yeast cells into which the gene for production of the hepatitis B virus outer coat has been inserted. The outer coat is not infectious, but when injected into humans, it can provoke a protective reaction within the human body against the entire virus.

Other important drug approvals during the year included Digibind, an antidote for life-threatening overdoses of the commonly prescribed heart drug digitalis, and Buspar, an anti-anxiety drug without many of the undesirable side effects of previously available drugs in that class. (A listing of major new drugs and biologicals approved in FY 86 is attached as Appendix E.)

One reason for FDA's progress in new drug review has been the implementation of the NDA Rewrite, the new set of regulations streamlining the NDA process. These regulations, which became fully effective in May 1986, are being supplemented by a series of guidelines to help drug companies prepare NDAs in a more uniform and efficient format. A public workshop to discuss these guidelines was held in the spring of 1986.

The Center also initiated a number of management improvements to accelerate the review of safe and effective new drugs. This included the delegation of certain NDA signoff authority in November 1985 from office level to division level. This new delegation authorized the six division directors to approve applications for new salts, some new formulations, and certain new indications for approved drugs. In the last five months of FY 86, FDA's six reviewing division directors acted on 26 NDAs under this new authority. The new drug division directors now handle about 50 percent of all new drug applications without subsequent review by upper management. This allows the FDA office directors to focus their attention on the more complex applications.

Complementing these advances in the review process for new drugs is the Center's overwhelming success in the review of generic drugs through the timely implementation of the Drug Price Competition and Patent Term Restoration Act of 1984. Under this Act, FDA is authorized to accept abbreviated new drug applications (ANDAs) for generic versions of safe and effective drugs approved since 1962. By January 1, 1986, six months ahead of its target date, the Center was completing 96 percent of its initial ANDA reviews in less than 140 days, well within the 180 days required by law. Overall, during FY 86, the Center approved 616 ANDAs, and by the end of the fiscal year, a total of 62 pioneer drugs first approved after 1962 were open to generic competition.

FDA evaluates ANDAs on the basis of bioequivalence of the generic drug to the brand name pharmaceutical, based on regulations covering bioequivalence issued in 1977. To determine if the present system and regulations need updating, FDA held a three-day bioequivalence hearing at the close of September 1986, which afforded all parties interested in bioequivalence issues an opportunity to present their views. It was attended by more than 800 representatives of academia, industry, the health care community, trade and professional associations, and the government.

Meetings such as the hearing on bioequivalence are designed to promote improved communication between FDA, academia, consumers, and the industry. The Center held 14 of those workshops during the year. Other topics covered included controlled release dosage forms, allergenic extract standardization, and blood-transmitted diseases in hemophiliacs.

Finally, FDA is involved in a number of innovative approaches to making lasting improvements in the drug approval process. These include: the PMA Ad Hoc Committee on FDA Issues which is working on such projects as increased use of computer technologies in NDA reviews; a Forum on Drug Development and Regulation, to be established under a contract with the Institute of Medicine; and legislation proposed by the Administration that would allow FDA to collect user fees as a way of recovering the cost to the agency of reviewing new drug products.

There is some indication that this kind of cooperation may already be having an effect. FDA analysed the overall drug development time (from initial IND submission to final NDA approval) for 15 U.S. developed new chemical entities (NCEs) approved in 1985 with a similar number approved in the early 1980s. This analysis showed that those NCE's approved in 1985 had a shorter drug development time by almost two years from the ten years experienced earlier. In the future, FDA believes that improved procedural guidelines --together with closer consultation during the IND phase--will result in higher quality New Drug Applications. Better applications will have a better success rate and better timeliness rate in FDA's review process.

Once a drug is brought to market, postmarketing surveillance is of critical importance in bringing to light rare, long-term, or latent side effects. The NDA Rewrite, discussed above, has strengthened adverse drug reaction reporting, and through an additional regulation, adverse drug reaction reporting requirements were broadened to cover all prescription drugs, including older drugs that predate current law. In FY 86, CDB received approximately 60,000 adverse drug reaction reports, continued to upgrade its review of these reports, and conducted experimental programs to encourage adverse reaction reporting from physicians.

FDA and the pharmaceutical industry recognize that drug development and monitoring do not stop when a drug is approved. A recent example of this was the discovery of flank pain and renal failure, which led to revised labeling for a new non-steroidal anti-inflammatory drug, Suprol. In another instance, the frequent development of severe hemolytic anemia was associated with an antidepressant drug, Merital, which was withdrawn from the market by its manufacturer.

FDA is actively collaborating with other nations and with international organizations, such as WHO, to improve international postmarketing surveillance, since it is clear that many pharmaceuticals are used world-wide.

Through its research programs in drugs and biologics, the Center for Drugs and Biologics (CDB) attempts to work in concert with the other Public Health Service (PHS) agencies and with academia and regulated industry to foster the development of new products and to provide a sound scientific basis for their regulation.

In addition to the AIDS-related research discussed earlier, the Center has maintained other research programs dealing with a broad spectrum of problems which are today, or will be in the near term future, related to new products. The new acellular pertussis (whooping cough) vaccines are a good example. Research continues on the development of improved versions of currently approved products. CDB's Division of Bacterial Products' pertussis laboratory is working in collaboration with its counterparts at the Centers for Disease Control (CDC) and the National Institutes of Health (NIH) and in international efforts to evaluate the characteristics of this new class of vaccines which hopefully will prove to be safer and as effective, perhaps even more effective, than the older products. CDB scientists have assessed candidate products, worked to develop serological tests for the disease, and have studied the components of the organism of potential importance. Overall, in FY 86 the Center's scientists made over 300 contributions to the scientific literature.

In the over-the-counter (OTC) drug area, FDA issued in May a final rule providing manufacturers with flexibility in labeling language used to describe the intended use of an OTC product. Before, the agency's "exclusivity" policy permitted only official language approved by FDA to be used on an OTC drug label. The new rules free manufacturers to use their own words to describe an OTC drug's intended use, so long as the alternative wording is truthful and not misleading. Under the regulation, manufacturers may (1) use the official FDA-approved wording; (2) use other truthful statements; or (3) use the official wording in one section of the label and synonymous truthful statements elsewhere.

Another nonprescription labeling change implemented in 1986 was the requirement for certain aspirin-containing OTC drug products to be labeled with a warning about the possible association between the use of aspirin and the incidence of Reye syndrome, a rare but sometimes fatal disease. CDB officials are cooperating closely with the Centers for Disease Control on additional studies on this matter. The agency also proposed warning labels for prescription drugs containing sulfites.

Finally, FDA published during FY 86 a number of important OTC monographs under the general umbrella of the OTC review. These included tentative final monographs for: (1) internal analgesic and antipyretic drug products; (2) exocrine pancreatic insufficiency drug products; and (3) dandruff, seborrheic dermatitis, and psoriasis drug products. They also included final monographs for anthelmintic drug products and topical otic drug products (drug products for use in the ear). (A list of significant regulations published in the FEDERAL REGISTER during FY 86, including OTC monographs, is attached in Appendix E.) FDA views the publication of the final OTC labeling regulation, described above, as accelerating the pace of OTC monograph development in the future.

The Center's FY 86 accomplishments were under the able leadership of Harry M. Meyer, Jr., M.D., and his deputy, Paul Parkman, M.D. On October 1, Dr. Meyer retired after 31 years of outstanding Federal service. An international authority on biologics and infectious diseases, he is particularly known for his work in the early development of a measles vaccine and his development, with Dr. Parkman, of a German measles (rubella) vaccine.

CENTER FOR DEVICES AND RADIOLOGICAL HEALTH

A new look at the Medical Device Amendments and their implementation is the second goal of the Action Plan, and the Center for Devices and Radiological Health (CDRH) is strongly committed to this goal. In 1985, CDRH Director John C. Villforth established Criticism Task Forces to analyze and seek possible solutions to problems that have developed in FDA's implementation of the 1976 Amendments to the Food, Drug, and Cosmetic Act. The resulting recommendations have been incorporated into the Action Plan and generally fall into three categories: product approvals, postmarket surveillance, and education and science activities.

The new product review area received the greatest amount of attention. The Health Industry Manufacturing Association (HIMA) Product Approval Task Force was helpful in formulating recommendations in this area. Some projected changes include (1) expanding criteria to eliminate unnecessary premarket notifications for certain medical device products--projected to reduce unnecessary applications by 1,000 over a three-year period; (2) allowing the addition of new institutions and investigators to conduct studies on investigational devices without prior FDA approval--estimated to reduce unnecessary submissions by 1,000 per year; and (3) placing on applicants for premarket approval of new devices the initial responsibility for safety and effectiveness summaries that would ordinarily be wholly prepared by FDA--expected to shorten review time by a full month for each device.

Significant progress has been made in enhancing the productivity of the new product review process while increasing the quality of the review process. For example, in FY 86, the Center approved a record 72 original premarket approval applications (PMAs), compared to 37 such approvals in FY 85. CDRH also approved a record number of PMA supplements, 477, which compares favorably to the previous record of 377 approved in FY 85. For investigational device exemption (IDE) applications, review time was reduced from an average of 37 days in FY 85 to 28 days in FY 86. For IDE supplements, average review times dropped from 33 days in FY 85 to 21 days in FY 86. (More detailed data on these product approval actions are contained in Appendix F.)

During this time, PMAs were approved for two innovative new pacemakers, the Activatrax and the Stat-Pace II, representing significant advances in medical technology. The Activitrax automatically adjusts the pacing rate for the heart in response to the demand created by the user's differing activities, while conventional pacemakers only keep the heart rate from falling below preset levels. The Stat-Pace II is a trans-esophageal pacemaker used for temporary therapeutic or diagnostic stimulation of the heart, without the need for and the risk attendant on a trans-venous pacemaker.

Early in FY 86, FDA approved an automatic implantable defibrillator that corrects potentially fatal disturbances in the heart's rhythm by sending a series of electrical impulses to the heart. The implantable defibrillator is intended for an estimated 400,000 people in the United States with tachycardia or fibrillation who are not helped by anti-arrhythmia drugs. In clinical trials, the device was shown to reduce deaths in this group to less than 5 percent per year.

FDA also issued a premarket approval for a 22-channel implantable cochlear hearing prosthesis for hearing-impaired adults that permits perception of a range of sound, rather than only the presence of sound as permitted under earlier devices. Essentially, the device provides improvements in speech recognition in conjunction with lip reading.

Over the past year, artificial heart transplants continued to be much in the news. The quality of life of patients with the implanted Jarvik-7 artificial heart, first approved for use at the University of Utah in 1981, has come under careful scrutiny. Patients in whom this artificial heart had been implanted suffered strokes, and in December 1985 the issue of permanent implantations was discussed at a meeting of the Circulatory System Devices Advisory Panel. Following the panel's recommendation, FDA set additional requirements for the permanent artificial heart program. The agency has also approved specific medical centers to use the Jarvik-7 artificial heart in patients awaiting human donor hearts. This temporary use is known as "bridge to transplant."

Two important regulations affecting new product review were published. The final premarket approval regulation, which assists manufacturers by providing more specific guidance, is expected to improve the efficiency of the device review process. FDA also published in the FEDERAL REGISTER a notice announcing its policy to establish performance standards for class II medical devices. Because FDA does not have the resources to establish standards for all class II devices simultaneously, Congress authorized the agency to establish priorities for use in applying standards-setting proceedings to class II devices. The policy specifies factors FDA will take into account in setting priorities for establishing standards.

In postmarket surveillance this was the first full fiscal year during which the medical device reporting regulation has been in effect, and nearly 17,000 reports were received. In response to a problem brought to FDA's attention before the regulation became effective, Shiley, Inc., of Irvine, California, with FDA's concurrence, sent a letter to physicians warning them not to implant larger sizes (29-33mm) of the 60 degree convexo-concave Shiley mechanical heart valves in patients because of the risk that a strut in the valves could fracture.

FDA also entered into an agreement with the United Kingdom concerning mutual recognition of inspections, the first such agreement with another country in the medical device area. The agreement will make it possible for both countries to conserve expenditures and inspection resources.

A proposed rule to establish a National Pacemaker Registry was also published. The regulation, which will be jointly administered by the Health Care Financing Administration (HCFA) and FDA, requires the submission of information regarding pacemaker and pacemaker lead implantation for which payment is requested under Medicare. HCFA has begun reporting information to FDA, and, as of the end of September, over 74,000 records were entered into the registry. The final rule is being prepared.

Finally, the Center participated in a number of educational and scientific activities. In June, FDA cosponsored with the World Health Organization and Pan American Health Organization the first International Conference of Medical Device Regulatory Authorities (ICMDRA) in Washington, D.C., which was attended by 53 nations.

Education is an essential method used by the Center to ensure proper use of complicated medical devices. Not only must these devices be safe and effective, but they must be used properly. For example, FDA staff developed a checkout procedure for anesthesia gas delivery systems in cooperation with anesthesiology professionals, biomedical engineers, and manufacturers. The procedure, which is practical for daily use, is capable of detecting common errors and equipment defects and is part of a larger educational program by FDA and anesthesiology professionals to help reduce patient injuries and deaths in anesthesiology. Another CDRH educational activity was the scoliosis exposure reduction program. Scoliosis is a lateral curvature of the spine which afflicts 4.5% of school-age children. CDRH developed a screening program for scoliosis, and widely disseminated this information to professional organizations, consumer groups, and via specially prepared videotapes.

FDA also published a report on the utility of presurgical chest x-ray examinations, developed in cooperation with appropriate health professional societies, which discourages routine chest x-rays of surgical patients; and published emergency use guidelines to assist clinicians in determining their regulatory obligations in medical emergency situations. The guidelines allow a single emergency use for a medical device not approved by FDA for investigational use on human patients, but an application for an investigational device exemption (IDE) is required before any subsequent use.

The Center is working to develop special expertise in the new technology of microelectronics to keep pace with the proliferation of computer-chip and microelectronic components in medical devices and in biotechnology in medical devices. Training to keep field investigators and headquarters staff up-to-date in these areas is under way. The Center also helped to develop a new ultrasound imaging system in cooperation with scientists at Duke University. The system improves the spatial resolution and sensitivity of clinical sonograms without increasing patient exposure. Using their ultrasound expertise in another area, scientists at the Center are evaluating an experimental technique in which diagnostic ultrasound is used to characterize the performance of prosthetic heart valves. This laboratory research is part of the Center's program to evaluate the effectiveness and long-term performance of prosthetic heart valves. In a related project, the Center is conducting an international comparison of flow measurement techniques for prosthetic heart valves to demonstrate the equivalence of data obtained in different places by different manufacturers.

Scientists at the Center have completed an evaluation of the potential hazards associated with emissions of optical radiation from dental photopolymerization devices. The Center also published a second volume of a report that provides methodology and data relating to the fundamental imaging characteristics of radiographic screen-film combinations. The work was the result of a collaborative effort between the Center and the University of Chicago's Kurt Rossman Laboratories for Radiologic Image Research.

A recent Center study demonstrated for the first time that UVA radiation can induce mutations of cultured animal cells, indicating potential carcinogenic effects. (UVA radiation is the type emitted from the more recently marketed types of sunbeds and tanning booths found in commerical tanning salons.) In this study, Center scientists exposed selected cells from mice to levels of UVA radiation comparable to those emitted by standard tanning devices. A three- to four-fold increase in cell mutation was found in the exposed cells. The toxic effect of UVA radiation of the exposed cells was similar to that shown in previous studies with UVB radiation.

Finally, research into the testing of impedance-type apnea monitors has led to an in-house testing capability which will have an impact on new proposed standards for apnea monitors. CDRH is now attempting to generate an accurate data base of physiological signals that represent apnea events in an attempt to provide the best possible testing of impedance-type monitors. Overall, in FY 86, Center staff published over 50 papers in the scientific literature.

CENTER FOR FOOD SAFETY AND APPLIED NUTRITION

The year was one in which solid progress was made by the Center for Food Safety and Applied Nutrition, headed by Sanford A. Miller, Ph.D.. Food safety was once again an issue of paramount importance in a variety of areas, and microbiological contamination of food in particular became a major public health concern.

In fact, in this year of challenge, the food industry has been particularly beset. There have been the discoveries of pesticides and fungicides in hydroponic or greenhouse grown vegetables, ethylene dibromide in black pepper, heptachlor in milk, and listeria monocytogenes in a variety of dairy products, including ice cream, soft ripened cheese, and chocolate milk. (A number of these incidents are discussed above under the Office of Regulatory Affairs.)

As a result of the increasing number of incidents associated with dairy foods, the Dairy Products Safety and Compliance program was implemented on April 1. Under this program, FDA began conducting intensified check-ratings in interstate milk shippers' pasteurization plants and inspection in other plants. A microbiological surveillance program designed to detect pathogenic contamination of finished products was incorporated into check ratings and inspections. This program illustrated the effectiveness of the problem-oriented approach to food safety.

Food safety concerns prompted action in other areas as well. In July, FDA published two important regulations with regard to sulfites. Sulfiting agents are chemical preservatives that are used extensively in foods and drugs. FDA has determined that up to 1,000,000 individuals may be at risk of experiencing an adverse reaction to sulfiting agents. Some of these adverse reactions are likely to be life-threatening. The majority of individuals at risk are asthmatic, and the possibility of severe reactions increases markedly in steroid-dependent asthmatics. FDA has clarified its regulations to ensure that manufacturers understand that the presence of sulfites must be declared on the label of all packaged food products that contain ten or more parts per million sulfite. FDA has also revoked the generally recognized as safe (GRAS) status of the use of sulfiting agents on fresh fruits and vegetables that are served or sold raw, for example in salad bars. The practical effect of this is that all consumers may partake of these fresh fruits and vegetables in restaurants with no danger of suffering a reaction to sulfites. FDA is still evaluating the use of sulfites in other food products, including potatoes.

One outgrowth of the agency's experience with sulfites was the establishment of a formal postmarketing surveillance program to detect adverse reactions to foods. Should this program indicate any association between an adverse reaction and a food product, the agency will initiate appropriate investigations and scientific follow-up. This program will be extremely useful in monitoring substances about which the agency has received complaints and in determining the seriousness of the complaints.

Another outgrowth of the sulfites experiences was the establishment of FDA's ad hoc Advisory Committee on Hypersensitivity to Food Constituents, which met three times during FY 86 to review and evaluate the available literature on hypersensitivity to several additives, including sulfites, monosodium glutamate, sodium benzoate, aspartame, and FD&C yellow No. 5, as well as foods or food ingredients, such as legumes, cow's milk, eggs, chocolate, grains, seafood, molds and yeasts. The Committee will summarize its conclusions and recommendations regarding hypersensitivity to these food constituents in a final report due in the spring of 1987.

FDA applied a carefully reasoned process of risk assessment in a proposed regulation published on December 18, 1985 which would ban the use of the chemical methylene chloride in cosmetic products. Methylene chloride is used in a variety of consumer and industrial products as a solvent and flame suppressant, especially in hair sprays. Based on studies indicating the inhalation of methylene chloride causes cancer in laboratory animals, FDA concluded that the continued use of this chemical in cosmetics was sufficiently high as to pose a significant risk to the public health. Methylene chloride is also used as an extraction solvent to remove caffeine from coffee. However, FDA assessed the extremely low residual level of methylene chloride in decaffeinated coffee to present virtually no human health risk, and therefore concluded that no additional restrictions on this use would be needed to protect the public health.

Methylene chloride represents one application of the de minimis principle (i.e., the law does not concern itself with trifles). In another, final rules were recently published permanently listing the color additives D&C Orange No. 17 and D&C Red No. 19 for external application. FDA has been "provisionally listing" a number of color additives to allow for the completion and evaluation of studies of the safety of the use of these additives. To aid its decision-making on the provisionally listed color additives, FDA established a panel of experts to review the safety data on FD&C Red No. 3, D&C Red Nos. 8, 9, 19, and 37 and D&C Orange No. 17. This panel was asked to determine whether it is possible to quantify the carcinogenic risk presented by the use of these color additives, and if so, what the levels of risk are. After receiving a final peer-reviewed report on these color additives, the agency reviewed that report. FDA's final action on Orange No. 17 and Red No. 19 was based on the conclusion that the risk posed by use of these substances is so trivial as to represent virtually no real threat of cancer to the public. Additional final determinations are being prepared.

In April of 1986, FDA published a final regulation to allow irradiation of certain foods after taking into account the comments on the proposed rule on irradiated foods, published in 1984. FDA also published final regulations specifying nutrient requirements for infant formulas; setting up requirements for infant formulas that are exempt from the Infant Formula Act; and revising the good manufacturing practice regulations for foods. The final regulation requiring sodium labeling as a mandatory part of nutrition labeling became effective on July

1, 1986. Among other things, this regulation establishes definitions for the terms "low sodium," "very low sodium," "sodium free," and "reduced sodium."

Food labeling issues also continued to be debated and evaluated as a means of disseminating to consumers important information bearing on nutrition and health. Recently, industry, consumer advocacy groups, professional societies, and the National Cancer Institute have suggested that food labels, by virtue of their proximity during the purchase, preparation, and consumption of food, are suitable for conveying information regarding the relationship between diet and health, including specific health problems. FDA believes that it is important to inform and educate the public in an effective manner about well-substantiated findings concerning this relationship, and is developing criteria for evaluating the propriety of health messages in food labeling..

In its surveillance of imported foods, FDA has discovered an increase in the number of violations of the FD&C Act. In FY 85, FDA detained and charged some 16,700 entries with a violation of the Food, Drug and Cosmetic Act. In FY 86, this figure was around 20,600--representing an increase of 23 percent. Problems included Listeria in soft cheeses, pesticides in foreign produce, and contaminated fish and shrimp. Therefore, the agency intends to increase its investigative efforts in this area. FDA will also increase its efforts to help foreign governments better understand the requirements of the FD&C Act. For example, CFSAN has promoted formal Memoranda of Understanding requiring foreign governments to certify that certain food products comply with FDA standards prior to being shipped to the United States. FDA continues to support the international organizations involved in promoting and regulating food safety throughout the world such as the World Health Organization, the Pan American Health Organization, and the United Nations Food and Agriculture Organization. This year, particular attention has been placed on providing manpower and technical advice to the Pan American Health Organization as a followup to the 1985 Inter-American Conference on Food Protection.

CFSAN has a broad-based research program directed toward detection, identification, and hazard determination on natural and man-made contaminants in foods and cosmetics, as well as toward research in new foods and the nutritional quality of foods. In 1986, the Center pursued a variety of studies in its nutrition-toxicology program, including investigations into factors affecting nutrient needs, the bioavailability of nutrients, nutrient surveillance, and methods for nutrient analysis. In addition, CFSAN has continued studies involving pesticides, industrial chemicals, and toxic elements which may enter food, as well as research studies on natural toxins such as mycotoxins and seafood toxins. Approximately 110 published scientific papers have resulted from these studies. Analytical capabilities were enhanced by adding a new nuclear magnetic resonance spectrometer for identifying organic constituents in foods and color additives and a modern inductively coupled plasma spectrometer for identifying multiple substances in nutrition and toxicological research. In addition, a high performance liquid chromatograph was coupled successfully with a mass spectrometer to expand uses of that valuable instrument. Detection of food adulteration using pattern recognition techniques is one particularly exciting area of research undertaken in chemistry and mathematics.

In the area of cosmetic safety, CFSAN continued development of analytical methods to identify hazardous ingredients, constituents, and microorganisms which may be in cosmetics. The Center also conducted studies to understand contact sensitization, skin metabolism and penetration, as well as the potential for systemic harm from absorbed cosmetic ingredients. These included efforts to develop in vitro methodology to give skin absorption values in agreement with in vivo results.

At the heart of its effort to identify and predict risk is the new MODULE I Beltsville research facility. MOD I is now essentially completed, and CFSAN will soon move its animal research facilities to the new complex. This new facility will allow FDA the flexibility to initiate future studies in a short time, and modify or redirect existing studies as results dictate.

CENTER FOR VETERINARY MEDICINE

Food safety has also been an area of concern for the Center for Veterinary Medicine (CVM)--from the standpoint of residues of substances potentially harmful to humans in meat, milk and eggs--under the direction of newly appointed Center Director, Gerald Guest, D.V.M. Formerly, Dr. Guest had served as the Center's Deputy Director since 1982.

Improved productivity in the review processes for new animal drug applications and investigational new animal drug applications has continued. In FY 86, CVM received approximately 1,500 New Animal Drug Application (NADA) submissions, and the review of 1,400 of these were completed within statutory time limits. Approximately 2,400 Investigational New Animal Drug Application (INADA) submissions were also received, with 2,000 completed within statutory time limits.

In March 1986, CVM published the final regulations setting up the Second Generation Medicated Feed Program and revising procedures for the approval of animal feeds containing new animal drugs. These regulations, which became effective May 2, 1986, categorized animal drug use in animal feeds based on potential human health risks. On August 4, 1986, CVM approved approximately 2,500 medicated feed applications, which represented the first group of applications approved under the new program. This group of applications was approved simultaneously in order to minimize disruption of the industry and to provide comparable opportunities to all applicants.

FDA has published in the FEDERAL REGISTER a proposal and series of guidelines that have come to be known as the Animal Drug Safety Policy. About 80 percent of livestock and poultry in this country are treated with some animal drug or feed additive. The Animal Drug Safety Policy is intended to protect consumers from residues of potentially cancer-causing drugs and feed additives that might be used to treat food animals. Under this policy, if tests show a new animal drug has a carcinogenic potential, it can only be considered for use in food-producing animals if the manufacturer can provide a test--suitable for routine use by government inspectors--to detect any significant residue that might be left in meat, eggs, or milk.

The Center has made substantial progress in its efforts to ensure that potentially harmful drug residues do not remain in foods. FDA-approved veterinary drugs--some 1,500--account for 90 percent of all marketed drugs used in food animals. The remaining unapproved products which FDA has not sought to remove from the market include vitamins, minerals and other substances, such as animal liniments, that have no known risk to humans, as well as some medications and other products for non-food pets. A Congressional hearing reviewed these unapproved products, and action to respond to the concerns expressed at the hearing is well under way. For example, during FY 86, the Center developed an automated data system to improve its knowledge of animal drugs in the marketplace. At this time, there are over 12,000 drug products in the automated inventory. The inventory is being used to alert the Center when unapproved animal drugs present a potential health hazard.

Before the 1980's, it was the policy of the Center that veterinarians could use any legally obtained drug in food-producing animals as long as no residue of that drug remained in edible tissues. To address the increasing abuse of drugs in food-producing animals that FDA has observed in recent years, the agency published what has come to be known as the extra-label use policy in May 1984. Under this policy, all drugs used in food-producing animals are required to be used in accordance with label directions, except in those instances where approved drugs are either not available or not effective and, in the professional judgment of a veterinarian, deviation will protect animals and not endanger human health. The policy has been modified in 1986 to give FDA investigators guidance in bringing legal actions against veterinary drug offenders. FDA field support for CVM has increased in FY 86, resulting in a 15 percent increase in enforcement actions over FY 85.

FDA also believes a mechanism, similar to that used for human drugs, is needed to control the illegal distribution of veterinary prescription drugs among animal producers. The key to effectiveness of such a system is the establishment of a full partnership with the states, including the state licensing of wholesale distributors and pharmacists, as well as closely monitoring their activities. With this in mind, the Association of Food and Drug Officials, in conjunction with other state regulatory officials and with FDA's assistance, is developing a draft model code which should provide a basis for uniform state laws and regulations for veterinary prescription drug distribution. Recognizing that some states may already have adequate laws and regulations, but lack the resources to enforce them, FDA has contracted with the Colorado Department of Health to develop a comprehensive statewide program to control illegal distribution and sales of veterinary prescription drugs in that state. Evaluation of preliminary data indicates that this contract has been very successful, and FDA will consider using contract funds to expand this activity to other states.

In FY 86 Center staff published several important papers in the scientific literature and the Center's research program placed increased emphasis on analytical methods development. During the initial phase of this program, emphasis is being placed on the development of new technology to enhance the tissue extraction procedures and quantitative determinative techniques. The Center is particularly concerned with the development of techniques to monitor residues of compounds used illegally in food producing animals and with improving the efficiency of its monitoring program operated in concert with the United States Department of Agriculture (USDA).

The Center also has in place the Minor Use Animal Drug Development Program, the objective of which is to support and supplement the Center's minor use policy by implementing a broad based program of scientific and applied research. This program incorporates the role of the USDA IR-4 Project in identifying minor use animal drugs and the development of the safety and efficacy data required for approval. CVM research is directed to the development of data bases that would affect the safe and effective use of these drugs.

Feed contaminants pose a continuing safety concern. CVM research in this area is currently addressing the transfer of aflatoxin in feed to milk, having compared the transfer rate in both corn and cottonseed meal. The Center is evaluating the stability of aflatoxin in feed following storage.

As part of an ongoing education program, the CVM Office of Information and Education mailed out 28 CVM UPDATES during the year. These are press releases to the farm press, reporting veterinary medical issues, such as policies on chemical additives used in animal products, availability of a report on emerging developments in veterinary biotechnology, and approvals of ionizing radiation for treatment of laboratory animal diets. The office also prepared two audio-visual programs on the safety of meat, milk, poultry, and eggs. These were prepared for education and orientation and mailed to the district and consumer affairs offices.

FDA has also recently completed a study of biotechnology activities in the animal health industry. Findings show that some 92 domestic firms are involved in biotechnology research and development, and 200 distinct veterinary products and processes based on these new technologies have been targeted for commercialization.

CVM is also preparing for changes in the way generic animal drugs could be approved. Animal drugs were not included in the Drug Price Competition and Patent Term Restoration Act, but similar legislation to cover animal drugs is being considered by Congress. Even if Congressional action does not occur, the agency will continue its efforts to determine the appropriate administrative changes necessary, if any, to further upgrade the approval process for generic animal drugs.

The agency has published a proposed regulation to establish procedures by which veterinarians could obtain bulk new animal drug substances to compound products for use in their own practice. This action would permit lower prices and product flexibility.

NATIONAL CENTER FOR TOXICOLOGICAL RESEARCH

FDA's Action Plan calls for the development of a comprehensive research program across FDA to evaluate and test, where practical, the assumptions used in risk assessment and to coordinate this effort with other Federal agencies. The Action Plan calls for a comprehensive policy committee under the leadership of the Director of the National Center for Toxicological Research (NCTR), Ronald W. Hart, Ph.D., to develop a comprehensive plan for evaluation and testing of the assumptions underlying risk assessment. The membership of this committee has been established. In addition, the Center has completed a major portion of an experimental risk assessment plan and established protocols to refine biomarkers of toxic insult, nutritional modulators of toxicity, and biostatistical study of risk assessment.

Because all of FDA's centers are involved in assessing and managing risks (as part of their public health problem identification and resolution efforts), the agency is seeking to improve current risk assessment procedures and techniques. Accordingly, NCTR is coordinating collaborative research (1) to improve understanding of the chemical reactions occurring in the human body in association with a toxic chemical; (2) to develop markers in the human body that can be used to demonstrate prior exposure to toxic chemicals; (3) to improve the design of scientific testing particularly in areas involving extrapolating from the results of animal studies to the likely effects upon humans; and (4) to coordinate toxicological research with other government (and private) research laboratories to conserve resources and share information.

The Center's leadership in risk assessment is reflected by Dr. Hart's chairing of a number of important task forces, including the Board of the Department of Health and Human Services Committee to Coordinate Environmental and Health Related Programs, the Red No. 3 Task Force, the National Risk Assessment Workshop, and the Science Panel of the Domestic Policy Council's Agent Orange Working Group.

NCTR's research efforts, guided by its stringent, multi-layered external peer review, continue to produce significant results. In FY 86, over 180 scientific publications appearing in peer-reviewed journals were prepared by NCTR scientists. Highlights from some of those publications are described below. Others are listed in Appendix D.

NCTR has continued its work in identifying biomarkers associated with risk assessment. One of those areas of exploration has taken the Center into an examination of some of the etiology associated with colo-rectal cancer, the second leading cause of cancer deaths in the United States. One published microbiology study presents a new in vitro model which simulates the lumen of the human large intestine and provides information on the role of intestinal microflora in the metabolism of xenobiotics. A second paper described the development of novel methods to measure the microbial degradation of pollutants in environmental microcosms.

In other important activities at the Center this year, a major study is under way (in collaboration with the National Institute on Aging (NIA)) on caloric restriction. During FY 86, NCTR has developed nine specific pathogen-free breeding colonies needed for this project and has allocated the animals to the experiments.

In addition, NCTR has been extremely active in developing collaborative programs with universities and individual groups. To make greater utilization of its facilities and to encourage scientific discussion, the Center has (1) continued to support a post-doctoral program with the Veterans Administration and the Little Rock VA Hospital, (2) continued to support an interdisciplinary toxicology graduate training program called IN-TOX with University of Arkansas Medical Sciences (UAMS), and, (3) continued to pursue the establishment of an 11-university NCTR Consortium. Also, the Center is exploring a program with UAMS and the Risk Science Institute to provide a university faculty sabbatical leave program.

In support of these research initiatives, the Center is in the final stages of completing the renovation of 100,000 square feet of new laboratory and animal care facilities. This follows the completion in 1985 of the construction/renovation of a new library, diet prep facility and a reproductive and developmental toxicology laboratory with an accompanying large animal care facility.

OFFICE OF THE COMMISSIONER

While the Commissioner and Deputy Commissioner of Food and Drugs are responsible for all of the operations of FDA, a number of special issues, including issues that cut across the work of more than one Center, are handled in the offices that make up the Office of the Commissioner.

In addition to completion of his domestic responsibilities, in FY 86, Commissioner Frank Young made major contributions in the international arena. In September, Dr. Young was nominated by the President to be the United States representative on the Executive Board of the World Health Organization, and his nomination for this important position was subsequently approved by the U.S. Senate. Dr. Young brings considerable experience in the international health area to this new role. For example, during FY 86, he served as a delegate and deputy head of the United States delegation to the World Health Assembly in Geneva and headed the United States delegation to a meeting on biotechnology policy held by the Organization for Economic Cooperation and Development in Paris, France. This meeting led to production of a document on recombinant DNA safety considerations that is used today in the United States, Japan, and Western Europe. The Commissioner also headed the United States delegations to the World Health Organization's Conference of Experts on the Rational Use of Drugs in Nairobi, Kenya; the Third United States/Israel Binational Symposium on Health Technology Assessment in Jerusalem; and the Tripartite Meeting in Montreal, Canada (attended by representatives of the governments of the United States, Canada and the United Kingdom).

The Deputy Commissioner shares responsibility with the Commissioner for managing FDA's programs and achieving its domestic and international missions. Deputy Commissioner John Norris's leadership and oversight role in implementing the Action Plan is described above in the Introduction. In his role as Chief Operating Officer, he is also responsible for managing the day-to-day affairs of the FDA and for overseeing implementation of FDA policy set by the Commissioner. In addition to completion of these responsibilities, during FY 86 Mr. Norris co-chaired with Commissioner Young The Health Effects Subcommittee of the President's Task Force on Chernobyl and the FDA hearing on the bioequivalence of generic drugs, and was responsible for the agency's oversight of the aspirin industry's voluntary program on Reye Syndrome. He also presided over the National Conference on Women's Health, and headed the successful delegations to Helsinki and Copenhagen related to the radiation contamination of foods following the Chernobyl nuclear accident, and to Rome and Geneva related to Chernobyl, Listeria contamination in foods, and post-marketing surveillance of drugs.

The Commissioner and Deputy Commissioner are supported by staff that comprise the Immediate Office of the Commissioner. This staff is responsible for coordinating action on a number of high priority issues within and outside FDA. For example, the Office of the Executive Assistant, headed by Joseph A. Levitt, has coordinated Agency-wide efforts on such important issues as Reye Syndrome, product tampering, AIDS, and Chernobyl. The Office also prepared correspondence, briefing materials and over 30 speeches on a wide variety of topics for the Commissioner and Deputy Commissioner. Similarly, Senior Assistant to the Commissioner for Program Policy, Mary Frances Lowe, was instrumental in facilitating many important regulations, the continuing review of over-the-counter drugs, and general improvements in the medical device program.

The Commissioner also is supported by his Special Assistant for Science, Mary Ann Danello, who coordinated the specific goals in the Action Plan related to new biotechnologies. This included the development of a training course for field investigators in state-of-the-art biotechnological production of new drugs, foods, and diagnostic tests, and setting up an agency-wide committee to coordinate biotechnology-related activities. In the biotechnology area, FDA has also participated in development of policy and procedures leading to a coordinated Government-wide framework for biotechnology policy through the leadership of Drs. Young, Danello, and Miller. Specifically, FDA is working with the Office of Science and Technology Policy and other scientific and regulatory Federal agencies on issues related to consistent regulation of products derived from new biotechnologies. These activities resulted in the publication of a regulation describing relevant policies in FDA, USDA, EPA, and NIH, as well as the framework for the government-wide coordinating council.

The Office of the General Counsel (OGC), under Chief Counsel Thomas Scarlett, was responsible for legal analysis of regulations as well as for important items of litigation, including a U.S. Supreme Court case, favorably decided, involving FDA's action level procedure for food contaminants, and lower court issues concerning over-the-counter "look-alike" drugs, the provisional listing and approval of color additives, the constitutionality of FDA establishment inspections after referral of criminal charges, and Federal government views on the liability of drug manufacturers for injury associated with FDA-approved vaccines. OGC attorneys participated in several noteworthy criminal investigations, including a major health fraud matter resulting in indictment and numerous cases involving the unlawful distribution of steroid drugs. OGC attorneys also participated in a number of administrative procedures in device regulation as well as enforcement policies.

The Office of Health Affairs (OHA), under Associate Commissioner Stuart L. Nightingale, M.D., coordinates the agency's international activities, and serves as liaison with the health professional community. The office is also responsible for such specialized activities as implementing FDA's duties under Title II of the Drug Price Competition and Patent Term Restoration Act. Title II provides patent term restoration for human drugs, medical devices, and food and color additives. For example, when a patent extension request is made for a product, FDA is required under the law to determine the regulatory review period for the product, i.e. the time spent on premarket testing and agency review.

In FY 86, OHA worked with the U.S. Patent and Trademark Office on 61 patent extension applications, most of which pertained to human drugs and the rest to medical devices. In most cases, the necessary findings were made and published in the FEDERAL REGISTER within 30 days of receipt of the application from the Patent Office. The agency also entered into a Memorandum of Understanding with the Patent Office that sets forth a system for determining a product's eligibility for patent term restoration; published proposed regulations to implement the law; and presented briefings on the extension policy at conferences and seminars attended by private sector attorneys and other interested persons.

The Office of Management and Operations (OMO), under Associate Commissioner Gerald F. Meyer, advises the Commissioner on all phases of management and coordinates funding, personnel, facilities, and equipment. The office's budgeting responsibilities were particularly challenging in FY 86, a year in which budgeting restraint was emphasized on a government-wide basis. Nevertheless, OMO effectively managed the agency's fiscal responsibilities, while also attending to the wide variety of administrative services that it provides in a timely and efficient manner.

Within OMO, an important Action Plan milestone was reached with the establishment of the position of Director of Information Resources Management. The Director's responsibilities include (1) installing and managing agency telecommunications, including such systems as electronic mail, local area and other data networks, and facsimile; (2) developing FDA's five-year automated data processing and telecommunications planning process; (3) providing consultation and technical advice to the Centers; (4) developing standards for linking systems between Centers; and (5) directing FDA's automated data processing (ADP) security program. All staff members are now in place.

The role of the Office of Planning and Evaluation under Associate Commissioner Gerald L. Barkdoll, in implementing FDA's Action Plan Reporting and Evaluation System (APRES) is discussed earlier in the Introduction. In addition to this key support provided to the agency planning process in FY 86, the office completed 29 evaluations of agency programs designed to improve their effectiveness, and conducted 14 economic analyses of agency policies.

Many important bills were considered by Congress and many major congressional hearings were held on FDA issues in FY 86. The Office of Legislative Affairs, under Associate Commissioner Hugh C. Cannon, played a vitally important role in coordinating Congressional activities for FDA. The office prepared testimony for FDA appearances before Congressional committees, monitored hearings affecting FDA, and advised the Commissioner with respect to the agency's legislative needs. (See Appendix H for a listing of the 27 Congressional hearings in FY 86 before which FDA officials testified.)

The Office of Consumer Affairs, under Associate Commissioner Alexander Grant, undertook major efforts in health fraud, patient drug information, and women's health. Health fraud, the promotion of false or unproven therapies for profit, is also an area of emphasis under the Action Plan. FDA is committed to fighting health fraud through both education and enforcement. FDA is working closely on this problem with groups such as the Federal Trade Commission, the United States Postal Service, the Pharmaceutical Advertising Council, and the Council of Better Business Bureaus. In this regard, FDA produced a health fraud brochure and developed an all-media public service campaign. In addition, FDA has contracted with the National Association of Consumer Agency Administrators to develop a health fraud information exchange system.

FDA continued to place priority on working with patients and health professionals to help assure that patients receive needed information on prescription drugs and worked closely with the National Council on Patient Information and Education in this regard. A number of programs addressing the needs of special target audiences, such as women, hispanics, and the elderly were initiated. In one of these jointly sponsored programs, October 1986 was designated the first annual "Talk About Prescriptions" month.

In June, FDA and the PHS Coordinating Committee on Women's Health Issues co-sponsored the National Conference on Women's Health, bringing together 600 people involved in programs aimed at promoting the physical and mental well-being of women. Goals of the conference were to bring the public health community together to focus on major health issues for women, presenting the best medical and scientific information by recognized experts in the area of women's health and providing baseline information for the development of educational programs within local communities. Panel discussions addressed such topics as older women's health, cancer, nutrition, osteoporosis, the menstrual cycle and issues in mental health, alcoholism, and substance abuse.

The Office of Public Affairs, under Associate Commissioner Jack W. Martin, is the focal point for disseminating news about FDA. During FY 86, the office prepared 53 news releases and 89 talk papers, and maintained liaison with the press--handling over 1,800 press inquiries, setting up more than 300 interviews, and assisting FDA executives in 8 press conferences. The office also publishes the FDA Drug Bulletin, on a quarterly basis, for health professionals, and the FDA Consumer magazine is published 10 times yearly for the lay public. In FY 86, the FDA Consumer received prestigious awards from an international competition for the Society for Technical Communications and from the National Association for Government Communicators. The office also assisted with education efforts to increase public awareness of health fraud, and received a special national award for their handling of news about tamperings.

During the year, FDA published columns in the Journal of the American Medical Association to make available to physicians current, useful information that can significantly affect medical practice--such as effective use of important new medical devices, new products derived through biotechnology, and problems associated with the food supply, such as reactions to sulfites. FDA has also begun similar columns in Pharmacy Times and Family Physician. The Office of Health Affairs and the Office of Public Affairs take the lead in preparing the columns.

The Office of Equal Employment and Civil Rights, under the direction of Percy Thomas, Ph.D., is responsible for providing leadership and direction to FDA to assure equal employment of minorities, women, and handicapped individuals. In FY 86, the office was determined by the Equal Employment Opportunity Commission to monitor an effective equal employment opportunity program at FDA. Technical assistance and training were provided to FDA employees to (1) improve their knowledge regarding equal employment opportunity and affirmative action; (2) prevent discrimination complaints; (3) enhance working relationships; and (4) provide information on career strategies. In addition, the Office set up a technical assistance and training resource library for employees.

Finally, solid gains were also made by the Office of Orphan Product Development under the direction of Stephen B. Fredd, M.D. During FY 86, FDA approved trientine hydrochloride, a designated orphan drug, for use in treating Wilson's disease, a potentially fatal genetic disorder in which the body cannot metabolize dietary copper. Penicillamine has been available to treat Wilson's disease for 30 years; however, a subgroup of patients with the disease cannot tolerate penicillamine, and this group will now have access to effective therapy. Other designated orphan drugs approved during the year included the human growth hormone Somatrem and digoxin-specific antibody fragments for treatment of potentially life-threatening digitalis intoxication. Orphan status was also granted to the AIDS drug azidothymidine (AZT), previously discussed in the Center for Drugs and Biologics section. In all, 108 orphan drug designations have been made since the program began; in FY 86, 21 new orphan product grants were issued, and 34 new orphan drug designations were made. A proposed rule incorporating the changes made by the Orphan Drug Act Amendments of 1985 is presently under development to clarify the procedures whereby sponsors of drugs for rare diseases or conditions (1) may become eligible for incentives provided by the Act, such as tax incentives; (2) may obtain designated orphan drug status; and (3) may obtain exclusive marketing for a drug that is designated an orphan drug.

CONCLUSION

Products regulated by FDA affect virtually every citizen in the United States: approximately 25 cents of every dollar spent by consumers is for products regulated by FDA. Through the agency's actions, at a cost of $1.80 per citizen per year, the safety and effectiveness of products valued at $550 billion per year is assured. This is a grave responsibility that is met by dedicated and highly professional employees. With the guidance of the Action Plan, the agency continued the renewal of its activities focusing on its 10 highest priority goals.

In a word, despite rigorous challenges, FY 86 was one of the most productive years in the history of FDA. Further progress will be sustained through the agency's commitment to its traditional responsibilities, through the complete implementation of Action Plan Phase I, and the development and implementation of Action Plan Phase II. The Food and Drug Administration is appreciative of the strong support it has received in fulfilling its responsibilities from the Administration and from Congress.

APPENDIX A

FDA POLICY BOARD

Frank E. Young, M.D., Ph.D.
Commissioner of Food and Drugs

John A. Norris, J.D., M.B.A.
Deputy Commissioner of Food
and Drugs

Gerald L. Barkdoll, D.P.A.
Associate Commissioner for
Planning and Evaluation

Hugh C. Cannon
Associate Commissioner for
Legislative Affairs

Mary Ann Danello, Ph.D.
Special Assistant for Science

Stephen B. Fredd, M.D.
Acting Director, Office of
Orphan Products Development

R. Alexander Grant
Associate Commissioner for
Consumer Affairs

Gerald B. Guest, D.V.M.
Director, Center for
Veterinary Medicine

Ronald W. Hart, Ph.D.
Director, National Center for
Toxicological Research

Joseph A. Levitt, Esquire
Executive Assistant to the
Commissioner

Mary Frances Lowe
Senior Assistant to the
Commissioner for Program
Policy

Jack W. Martin
Associate Commissioner for
Public Affairs

Gerald F. Meyer
Associate Commissioner for
Management and
Operations

Paul D. Parkman, M.D.
Acting Director, Center for
Drugs and Biologics

Sanford A. Miller, Ph.D.
Director, Center for Food
Safety and Applied Nutrition

Stuart L. Nightingale, M.D.
Associate Commissioner for
Health Affairs

Thomas Scarlett, Esquire
Chief Counsel

John Taylor
Associate Commissioner
for Regulatory Affairs

Percy Thomas, Ph.D.
Director, Office of Equal
Employment and Civil Rights

John C. Villforth
Director, Center for Devices
and Radiological Health

APPENDIX B

TOTAL NUMBER OF GOALS, OBJECTIVES AND MILESTONES

GOAL	OBJECTIVES	NUMBER OF MILESTONES	ACTUAL STARTS		ACTUAL COMPLETIONS	
			NUMBER	PERCENT	NUMBER	PERCENT
1	7	31	31	100	27	87
2	4	15	14	93	11	73
3	8	48	41	85	34	71
4	4	10	9	90	8	80
5	4	12	11	92	10	83
6	2	6	6	100	6	100
7	6	30	26	87	14	47
8	3	30	30	100	22	73
9	3	28	27	96	22	79
10	8	45	44	98	37	82
TOTALS 10	49	255	239	94	191	75

APRES STATUS AS OF SEPTEMBER 30, 1986

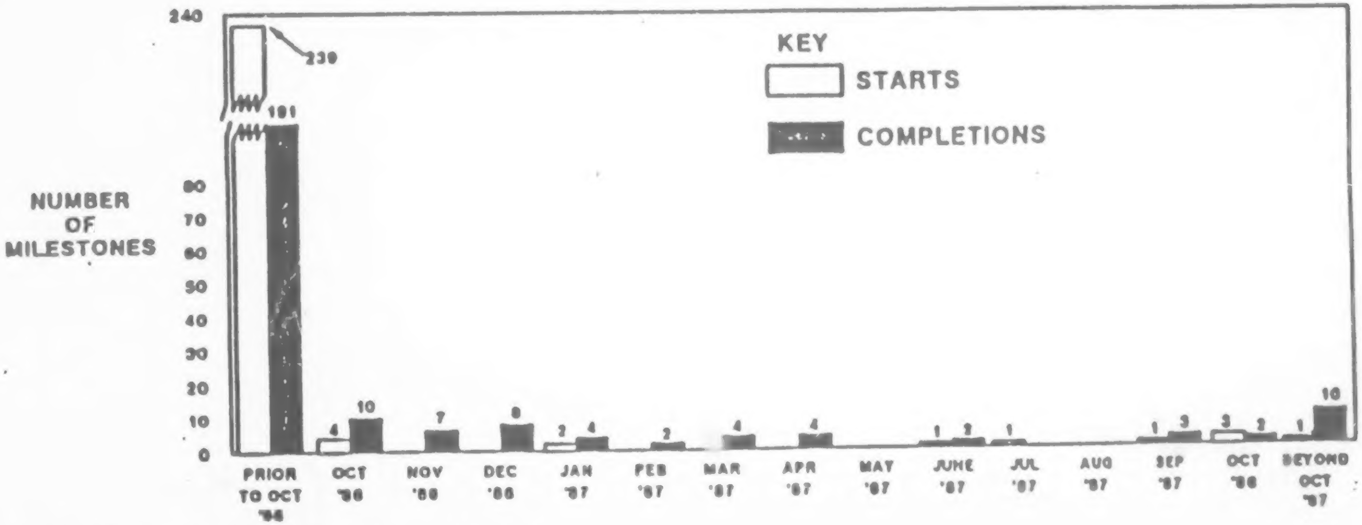
OBJECTIVES AND MILESTONES BY ORGANIZATIONS

ORGANIZATION	NUMBER OF OBJECTIVES	NUMBER OF MILESTONES	ACTUAL STARTS		ACTUAL COMPLETIONS	
			NUMBER	PERCENT	NUMBER	PERCENT
CDB	11	58	53	91	44	76
OHA	1	5	5	100	4	80
CDRH	6	30	29	97	21	70
CVM	1	2	2	100	2	100
CFSAN	8	46	40	87	27	59
NCTR	4	10	9	90	8	80
ORA	9	39	37	95	32	82
SAB	3	6	6	100	6	100
OCA	2	35	34	97	24	69
OMO	4	24	24	100	23	96
TOTALS	49	255	239	94	191	75

APRES STATUS AS OF SEPTEMBER 30, 1986

APRES MILESTONES

STARTS AND COMPLETIONS BY MONTH



APRES STATUS AS OF SEPTEMBER 30, 1986

APPENDIX C

SCIENTIFIC PAPERS
REPRESENTATIVE CONTRIBUTIONS BY FDA SCIENTISTS

Bailey, J.R., H.C. Cunny, M.G. Paule, and W. Slikker. Fetal Disposition of Delta-9-Tetrahydrocannibinol (THC) During Late Pregnancy in the Rhesus Monkey. *Toxicology and Applied Pharmacology* (submitted). (NCTR)

Birx, D.L., R.R. Redfield, and G. Tosato. Defective Regulation of Epstein-Barr Virus Infection in Patients with Acquired Immunodeficiency Syndrome (AIDS) or AIDS-Related Disorders. *New England Journal of Medicine*, 314:874-879, 1986. (CDB)

Bronaugh, R.L. and L.F. Stewart. Methods for in vitro Percutaneous Absorption Studies VI: Preparation of the Barrier Layer. *Journal of Pharmaceutical Sciences*, 75, No. 5:487, 1986. (CFSAN)

Burns, D.L. and C.R. Manclark. Adenine Nucleotides Promote Dissociation of Pertussis Toxin Subunits. *Journal of Biological Chemistry*, 261:4324-4327, 1986. (CDB)

Ellingson, O.L., R.J. Landry, and R.G. Bostrom. An Evaluation of Optical Radiation Emissions from Dental Visible Photopolymerization Devices. *Journal of the American Dental Association*, 112:67-70, 1986. (CDRH)

Faich, G.A. Adverse Drug Reaction Monitoring. *New England Journal of Medicine*, 314:1589-1592, 1986. (CDB)

Firestone, D., R.A. Niemann, L.F. Schneider, J.R. Gridley, and D.E. Brown. Dioxin Residues in Fish and Other Foods. *Chlorinated Dioxins and Dibenzofurans in Perspective* , ED: C. Rappe, G. Choudhary, and L. Keith, Lewis Publications, Chelsea, Michigan, 1986. (CFSAN)

Flamm, W.G., L.R. Lake, R.J. Lorentzen, A.M. Rulis, P.S. Schwartz, and T.C. Troxell. Carcinogenic Potencies and Establishment of a Threshold of Regulation for Food Contact Substances. *Risk Assessment* (in press). (CFSAN)

Frobish, R., B. Bradley, D. Wagner, P. Long-Bradley, and H. Hairston. Aflatoxin Residues in Milk of Dairy Cows after Ingestion of Naturally Contaminated Grain. *Journal of Food Protection*, 49:781, 1986. (CVM)

Furrow, R.D., E.L. Parbuoni, D.T. McKure, S.A. Gaines, J.A. Guasnieri, R.A. Carnevale, and M. April. Characterization of a Pasteurella Multocida (Serotype B) Bovine Pneumonia Pasteurellosis Model and the Effect of Antimicrobials During Peracute Infection. *Journal of Veterinary Pharmaceutical Therapy*, 9:264, 1986. (CVM)

Glinsmann, W.H., H. Irausquin, and Y.K. Park. Evaluation of Health Aspects of Sugars Contained in Carbohydrate Sweeteners: Report of Sugars Task Force, 1986. *Journal of Nutrition* (in press). (CFSAN)

Gridley, T., E. Allen, and B. Shakhi. Reducing the Effect of Chemiluminescence on the Efficacy of Extraction of Fortified Kidney Tissue as Measured by Liquid Scintillation System. *Nuclear Medicine Biology*, 113:57, 1986. (CVM)

Heflich, R.H., S.M. Morris, D.T. Beranek, L.J. McGarrity, J.J. Chen, and F.A. Beland. Relationships Between the DNA Adducts and the Mutations and Sister-Chromatid Exchanges Produced in Chinese Hamster Ovary Cells by N-hydroxy-2-aminofluorene, N-hydroxy-N'-acetylbenzidine and l-nitrosopyrene. *Mutagenesis*, 1(3):201-206, 1986. (NCTR)

Hilbert, S.L., V.J. Ferrans, and M. Swanson. Optical Methods for the Nondestructive Evaluation of Collagen Morphology in Bioprosthetic Heart Valves. *Journal of Biomedical Materials Research*, 20:1411-1421, 1986. (CDRH)

Hill, W.E., W.L. Payne, G. Zon, and S.L. Moseley. Synthetic Oligodeoxyribonucleotide Probes for Detecting Heat-Stable Enterotoxin-Producing *Escherichia coli* by DNA

Colony Hybridization. *Applied and Environmental Microbiology*, 50 (5): 1187, 1985. (CFSAN)

Hitchins, V.M., T.J. Withrow, K.M. Olvey, B.A. Harleston, O.L. Ellingson, and R.C. Bostrom. The Cytotoxic and Mutagenic Effects of UVA Radiation on L5178Y Mouse Lymphoma Cells. *Photochemistry and Photobiology*, 44:53-57, 1986. (CDRH)

Holohan, T. Pathophysiology of Circulating Immune Complexes: Their Role in Host/Tumor Interactions and Removal by Immunoabsorption Therapy. Chapter 3 in: Salinas, F.A., Hannah, M.G. (eds.), Contemporary Topics in Immunobiology, Vol. 15: *Immune Complexes in Human Cancer*. Plenum Publishers, N.Y., 1985. (OHA)

Insana, M.F., R.F. Wagner, B.S. Garra, D.G. Brown, and T.H. Shawker. Analysis of Ultrasound Image Texture Via Generalized Rician Statistics. *Optical Engineering*, 25(6):743-748, 1986. (CDRH)

Lang, N.P., D.Z.J. Chu, C.F. Hunter, D.C. Kendall, T.J. Flammang, and F.F. Kadlubar. Role of Aromatic Amine Acetyltransferase in Human Colo-Rectal Cancer. *Archives of Surgery* (accepted June 1986). (NCTR)

Leadbetter, M. and E. Allen. Liquid Chromatographic Determination of the Composition of Thiacetarsamide Solution. *Journal of Liquid Chromatography*, 9:1075, 1986. (CVM)

Leber, P. Establishing the Efficacy of Drugs with Psychogeriatric Indications. *Treatment Development Strategies for Alzheimer's Disease*, ED: T. Crook, R. Bartus, S. Ferris, and S. Gershon, Mark Powley and Associates, Inc., 1986. (CDB)

Manning, B.W., T.W. Federle, and C.E. Cerniglia. Use of a Semicontinuous Culture System as a Model for Determining the Role of Human Intestinal Microflora in the Metabolism of Xenobiotics. *Journal of Microbiological Methods* (in press). (NCTR)

Papas, A.W. Sub-Ambient Temperature-Regulated High Performance Liquid Chromatography. *Journal of Chromatographic Science*, 24:125-126, 1986. (ORA)

Placenia, A.M., G.S. Oxborrow, and J.T. Peller. Package Integrity Methology for Testing the Biobarrier Properties of Porous Packaging Materials Used in Medical Devices. *Medical Device and Diagnostic Industry*: Part I: Membrane Agar Plate Strike-through Method 2, 8(4):60-65; Part II: FDA Exposed-Chamber Method, 8(5):46-53; 1986. (ORA)

Pope, A., J. Heavner, J. Guarnier, and C. Knoblock. Trichlorfon-induced Congenital Cerebellar Hypoplasia in Neonatal Pigs. *Journal of the American Veterinary Medical Association*, 189:781, 1986. (CVM)

Quinnan, G.V., Jr., J.P. Siegel, J.S. Epstein, J.F. Manishewitz, S. Barnes, and M.A. Wells. Mechanism of T-cell Functional Deficiency in the Acquired Immunodeficiency Syndrome. *Annals of Internal Medicine*, 103:710-714, 1986. (CDB)

Sagripanti, J.L. and M.L. Swicord. DNA Structural Changes Caused by Microwave Radiation. *International Journal of Radiation Biology*, 50:47-51, 1986. (CDRH)

Saxton, W.L. Simultaneous Parameter Compensation in the Replication of Programmed Temperature Gas Chromatographic Measurements. *Journal of Chromatography*, 357:1-10, 1986. (ORA)

Sullivan, J.J. Analytical Techniques for Dinoflagellate Toxins. *Mycotoxins and Phycotoxins, Bioactive Toxins*, Vol. 1, ED: P.S. Steyn and R. Vleggaar, Elsevier Science Publisher, Amsterdam, 1986. (ORA)

Wagner, R.F., M.F. Insana, and D.G. Brown. Unified Approach to the Detection and Classification of Speckle Texture in Diagnostic Ultrasound. *Optical Engineering*, 25(6):743-748, 1986. (CDRH)

Wislocki, P.G., E.S. Bagan, A.Y.H. Lu, K.L. Dooley, P.P. Fu, H. Han-Hsu, F.A. Beland, and F.F. Kadluban. Tumorigenicity of Nitrated Derivatives of Pyrene,

Benz[a]anthracene, Chrysene, and Benzo[a]pyrene in the Newborn Mouse Assay. *Carcinogenesis*, 7(8):1317-1322, 1986. (NCTR)

Wolnik, K.A., F.L. Fricke, S.G. Capar, M.W. Meyer, R.D. Satzger, E. Bunnin, C.M. Gaston. Elements in Raw Agricultural Crops in the United States: Cadmium, Lead, and 11 Other Elements in Carrots, Field Corn, Onions, Rice, Spinach, and Tomatoes. *Journal of Agriculture and Food Chemistry*, 33:809. 1985. (ORA)

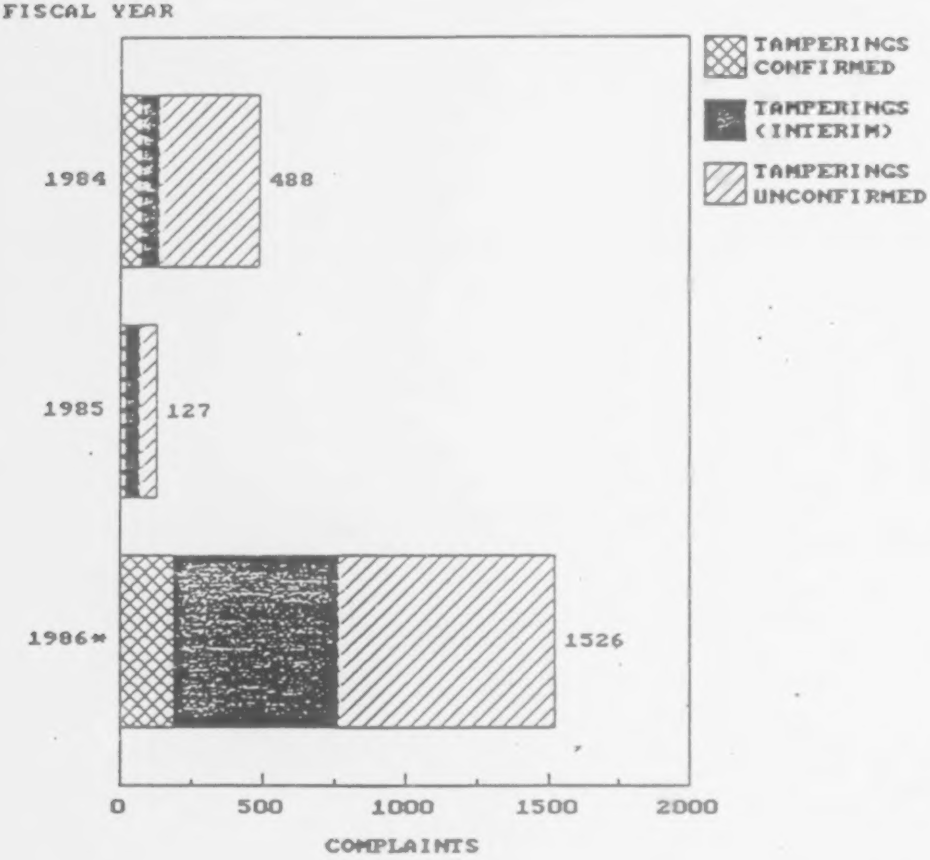
Zuck, T.L. Human T-cell Lymphotropic Virus, Type III, Antibody Testing in the United States: Experiences of the First Year. *AIDS: The Safety of Blood and Blood Products*. ED: J.P. Petricciani, I.D. Gust, and P.A. Hoppe, J.K. Wiley and Sons, London, 1986. (CDB)

APPENDIX D

FY 86 Tampering and Other FDA Incidents Involving Foods and Drugs

Sri Lanka Tea (Threatened Cyanide)	Jan. 1986
Peruvian Tea (Aztec Gold-Coca Leaves)	Jan. 1986
Reported Glass in Baby Food (Gerbers, Beechnut, and Heinz)	Jan. 1986
Chloramphenicol (Misuse of Animal Drugs)	Jan. 1986
Ethylcarbamate in Alcoholic Beverages	Jan. 1986
Girl Scout Cookies (Tampering)	Jan. 1986
Heptachlor in Milk and Other Dairy Products	Feb. 1986
Ethylene Dibromide in Black Pepper	Feb. 1986
Daminozide (Alar) Residues in Apples, Cherries, Grapes	Feb. 1986
Illegal Fungicides in Grapes From Chile	Feb. 1986
Aldrin Contaminant in Meat and Bonemeal	Feb. 1986
Heparin without Preservative (Nonsterility)	Feb. 1986
Johnson & Johnson's Tylenol Capsules (Cyanide)	Feb. 1986
Listeria in Imported Soft Cheese (French Brie)	Mar. 1986
Economic Adulteration of Domestic Olive Oil	Mar. 1986
Listeria in Domestic Mexican Style Soft Cheeses	Mar. 1986
SmithKline Beckman's Contac, Dietac, and Teldrin (Rat Poisoning)	Mar. 1986
Whitehall's Anacin-3 Capsules (Cyanide)	May 1986
Bristol Myers' Extra Strength Excedrin Capsules (Cyanide)	June 1986
Listeria in Ice Cream	July 1986
Over 200 Threats Involving Various Products (Including Ac'cent)	July/Sept. 1986
Kool Aid (Unconfirmed Cyanide)	Aug. 1986
Foodborne Illness on Airline Flight	Aug. 1986
Lipton Cup A Soup (Cyanide)	Sept. 1986

TAMPERING COMPLAINTS RECORDED BY FDA
BY FISCAL YEAR
1984 -- 1986*



* FY 1986 data incomplete.

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APPENDIX E

MAJOR NEW DRUGS AND BIOLOGICALS APPROVED BY FDA IN FY 86

PRODUCT NAME (GENERIC NAME)	MANUFACTURER	INDICATION / USE
Betagan *(Levobunolol Hydrochloride)*	*Allergan Pharmaceuticals*	*Beta Adrenergic Blocker*
Buspar *(Buspirone Hydrochloride)*	*Bristol-Myers*	*Anxiolytic*
Cefotan *(Cefotetan Disodium)*	*Stuart Pharmaceuticals*	*Antibiotic*
Cesamet *(Nabilone)*	*Eli Lilly*	*Antiemetic*
Cordarone *(Amiodarone Hydrochloride)*	*Ives Laboratories*	*Antiarrhythmic*
Cuprid *(Trientine Hydrochloride)*	*Merck Sharp & Dohme*	*Chelating Agent*
Dormalin *(Quazepam)*	*Schering*	*Hypnotic*
Femstat *(Butoconazole Nitrite)*	*Syntex Laboratories*	*Antifungal*
Indium In-111 Oxyquinoline *(Indium In-111 Oxyquinoline)*	*Amersham*	*Radioactive Diagnostic*
Intron-A	*Schering*	*Alpha Interferon*
Isovue-M *Isovue* *(Iopamidol)*	*E.R. Squibb and Sons*	*Diagnostic Radiopaque*
L-Carnitine *(L-Carnitine)*	*Sigma-Tau*	*Carnitine Replenisher*
Mexitil *(Mexiletine Hydrochloride)*	*Boehringer Ingelheim*	*Antiarrhythmic*
Moctanin *(Monooctanoin)*	*Ascot Pharmaceuticals*	*Gallstone Solvent*
Nix *(Permethrin)*	*Burroughs Wellcome*	*Pediculocide*
Omnipaque *(Iohexol)*	*Winthrop-Breon Laboratories*	*Diagnostic Radiopaque*
*Orthoclone OKT*3*	*Ortho*	*T-cell Antibody*
Orudis *(Ketoprofen)*	*Wyeth Laboratories*	*Anti-Inflammatory*
Primaxin *(Cilastatin Sodium)*	*Merck Sharp & Dohme*	*Renal Enzyme Inhibitor and Antibiotic*

MAJOR NEW DRUGS AND BIOLOGICALS APPROVED BY FDA IN FY 86 (Cont.)

PRODUCT NAME (GENERIC NAME)	MANUFACTURER	INDICATION / USE
Protropin (Somatrem)	*Genentech*	*Human Growth Hormone*
Recombivax HB	*Merck Sharp & Dohme*	*Hepatitis B Vaccine*
Roferon-A	*Hoffmann-La Roche*	*Alpha Interferon*
Suprol (Suprofen)	*Ortho Pharmaceutical*	*Analgesic*
Tambocor (Flecainide Acetate)	*Riker Laboratories*	*Antiarrhythmic*
Tegison (Etretinate)	*Hoffman-La Roche*	*Antipsoriatic*
Temovate (Clobetasol Propionate)	*Glaxo*	*Anti-inflammatory Corticosteroid*
Vasotec (Enalapril Maleate)	Merck Sharp & Dohme	Antihypertensive
Versed (Midazolam Hydrochloride)	*Hoffmann-La Roche*	*General Anesthetic*
Virazole (Ribavirin)	*Viratek*	*Antiviral*
Wellbutrin (Bupropion Hydrochloride)	*Burroughs Wellcome*	*Antidepressant*

APPENDIX F

Significant Regulations FDA Published in the Federal Register in FY 86

*STATUS **	*TITLE*	*PUB DATE*
PR	*OTC Male Genital Desensitizing Drug Products*	*10/02/85*
FR	*Nutrient Requirements for Infant Formulas*	*10/30/85*
PR	*Animal Drugs Safety Policy*	*10/31/85*
FR	*OTC Anticholinergic Drug Products*	*11/08/85*
PR	*OTC Internal Analgesic Antipyretic*	*11/08/85*
PR	*OTC Exocrine Pacreatic Insufficiency Drug Product*	*11/08/85*
PR	*Sulfiting Agents; Labeling in Rx Drugs*	*11/19/85*
FR	*Exempt Infant Formula*	*11/22/85*
PR	*Bacterial Vaccines and Toxoids (Classification)*	*12/13/85*
PR	*Aspirin-Containing Products (Reye Syndrome label warning)*	*12/17/85*
PR	*Ban on use of Methylene Chloride in Cosmetics; no action for use in decaffeinated coffee*	*12/18/85*
PR	*Vinyl Chloride Polymers*	*2/03/86*
ANPR	*Policy on Eligibility of Drugs for Orphan Designation*	*2/05/86*
FR	*Food Additives; Irradiation in Animal Feed and Pet Food*	*2/19/86*
PR	*Serologic Test for Antibody to Human T-Lymphotropic Virus Type III (HTLV-III)*	*2/21/86*
FR	*New Animal Drugs for Use in Animal Feeds*	*3/03/86*

Significant Regulations FDA Published in the Federal Register in FY 86 (Cont.)

STATUS *	TITLE	PUB DATE
N	D&C Red No. 8, D&C Red No. 9, D&C Red No. 37, D&C Orange No. 17, and D&C Red No. 3 - Availability of the Final Report of the Color Additive Scientific Review Panel	3/06/86
FR	Labeling for OTC Aspirin and Aspirin-Containing Drug Products	3/07/86
FR	Irradiation in the Production, Processing, and Handling of Food	4/18/86
PR	OTC Antidiarrheal Drug Products	4/30/86
FR	Labeling of OTC Drug Products (Revised "Exclusivity" Policy)	5/01/86
PR	Standards for Live Oral Poliovirus Vaccine	5/05/86
PR	Cardiac Pacemaker Registry	5/06/86
PR	Proposed Clarification of Requirements for New Drug Application Supplements	6/04/86
FR	Labeling of Children's Foaming Detergent Bath Products	6/05/86
FR	Termination of Provisional Listing of D&C Red No. 37 for Use in Externally Applied Drugs and Cosmetics	6/06/86
FR	Current Food GMP's Revised	6/19/86
FR	Adverse Drug Experience Requirements for Marketed Prescription Drugs WithoutApproved New Drug or Abbreviated New Drug Applications	7/03/86
FR	FD&C Yellow No. 5; Identity and Specifications	7/07/86
FR	FD&C Yellow No. 5; Permanent Listing for Use in Externally Applied Drugs and Cosmetics Generally; Termination of Stay; Confirmation of Effective Date, and Further Amendment	7/07/86

Significant Regulations FDA Published in the Federal Register in FY 86 (Cont.)

*STATUS **	*TITLE*	*PUB DATE*
FR	*Food Labeling; Declaration of Sulfiting Agents*	*7/09/86*
FR	*Sulfiting Agents; Revocation of GRAS Status for Use on Fruits and Vegetables Intended to be Served or Sold Raw to Consumers*	*7/09/86*
PR	*Patent Term Restoration Regulations*	*7/11/86*
FR	*Voluntary Filing of Cosmetic Product Experiences*	*7/16/86*
FR	*OTC Oral Mucosal Injury Drug Products and Oral Wound Healing Drug Products*	*7/18/86*
FR	*Premarket Approval of Medical Devices*	*7/22/86*
PR	*OTC Dandruff, Seborrheic Dermatitis, and Psoriasis Drug Products*	*7/30/86*
FR	*OTC Anthelmintic Drug Products*	*8/01/86*
FR	*Listing of D&C Red No. 19 for Use in Externally Applied Drugs and Cosmetics*	*8/07/86*
FR	*Listing of D&C Orange No. 17 for Use in Externally Applied Drugs and Cosmetics*	*8/07/86*
FR	*OTC Topical Otic Drug Products*	*8/08/86*

** PR - Proposed Rule*
ANPR - Advance Notice of Proposed Rulemaking
FR - Final Rule
N - Notice

APPENDIX G

FY 86 PERFORMANCE HIGHLIGHTS: FDA'S MEDICAL DEVICE REVIEW PROGRAM

GENERAL

- FDA's Center for Devices and Radiological Health (CDRH) has made more product review decisions in FY '86 than were made in FY '85, for each of its five major review categories (PMAs, PMA supplements, IDEs, IDE supplements, and 510(k)s).
- CDRH has reduced the number of pending documents in each of the five review categories. Except for PMA supplements, there were more review decisions made than new applications received. Average review time was also reduced in most categories.

PREMARKET APPROVED APPLICATIONS

- CDRH approved a record 72 PMAs, nearly twice the 37 approved in FY '85.
- CDRH reduced PMAs under active review from 103 to 63.

PMA SUPPLEMENTS

- CDRH approved a record 477 PMA supplements, compared to the previous record of 377 supplements approved in FY '85.

INVESTIGATIONAL DEVICE EXEMPTION (IDEs)

- CDRH reduced average IDE review time from 37 days in FY '85 to 28 days in FY '86, and increased the percentage of decisions made within 30 days from 82% to 93 %.*
- At the end of FY 86, CDRH had no pending overdue IDEs.

IDE SUPPLEMENTS

- Average IDE supplement review time was reduced from 33 days in FY '85 to 21 days in FY '86, and increased the percentage of decisions made within 30 days from 78 % to 90 %.
- CDRH made over 1,400 more IDE supplement decisions in FY '86 than in FY '85. Despite increased receipts, the number pending at the end of the year fell from 854 to 139.

PREMARKET NOTIFICATIONS (510 (k)s)

- CDRH made over 5,300 510(k) decisions in FY '86. The number pending at the end of the year was reduced from 1,337 to 1,041, and only 25 of these were active more than 90 days.

*Note: These statistics do not include IDEs and IDE supplements already overdue when FY 86 began.

FIGURE 1 - PMA APPROVALS FY 1980 - FY 1986

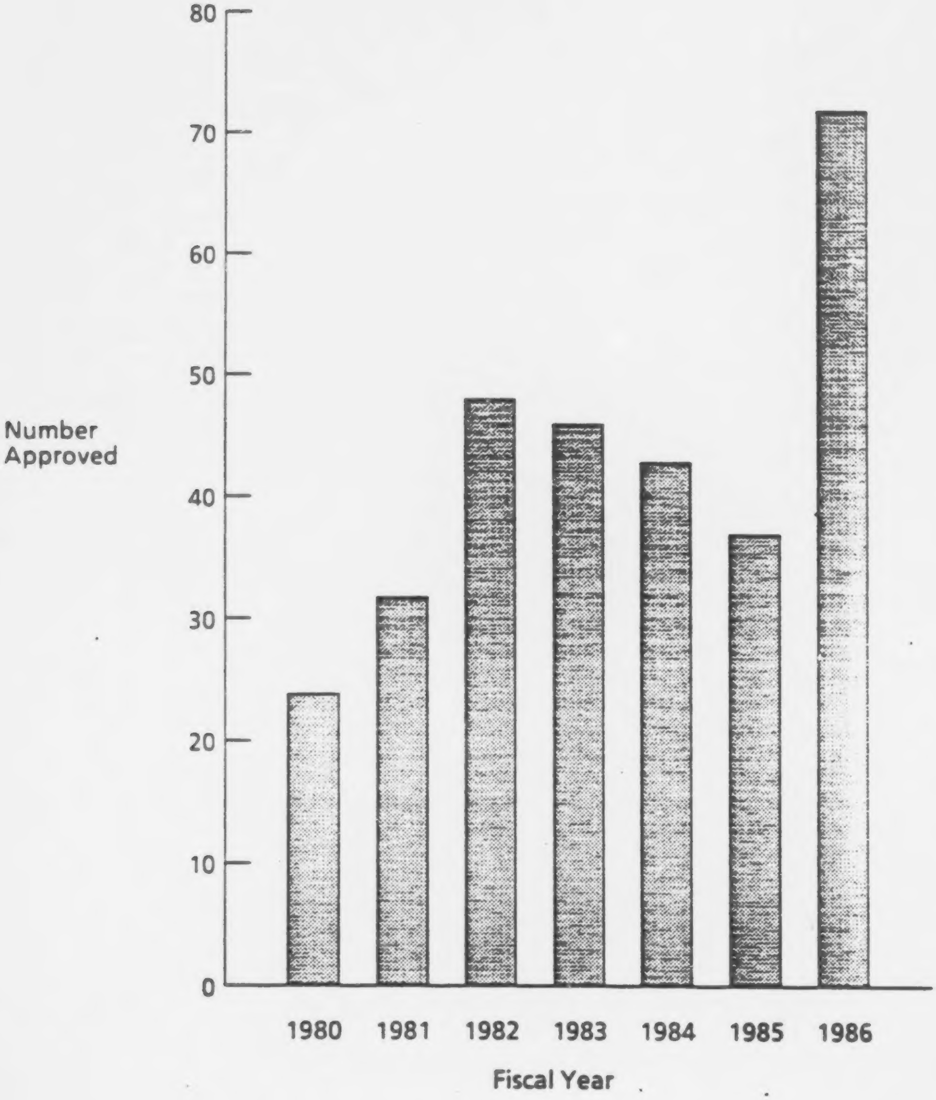


FIGURE 2 - PMA SUPPLEMENT APPROVALS
FY 1980 - FY 1986

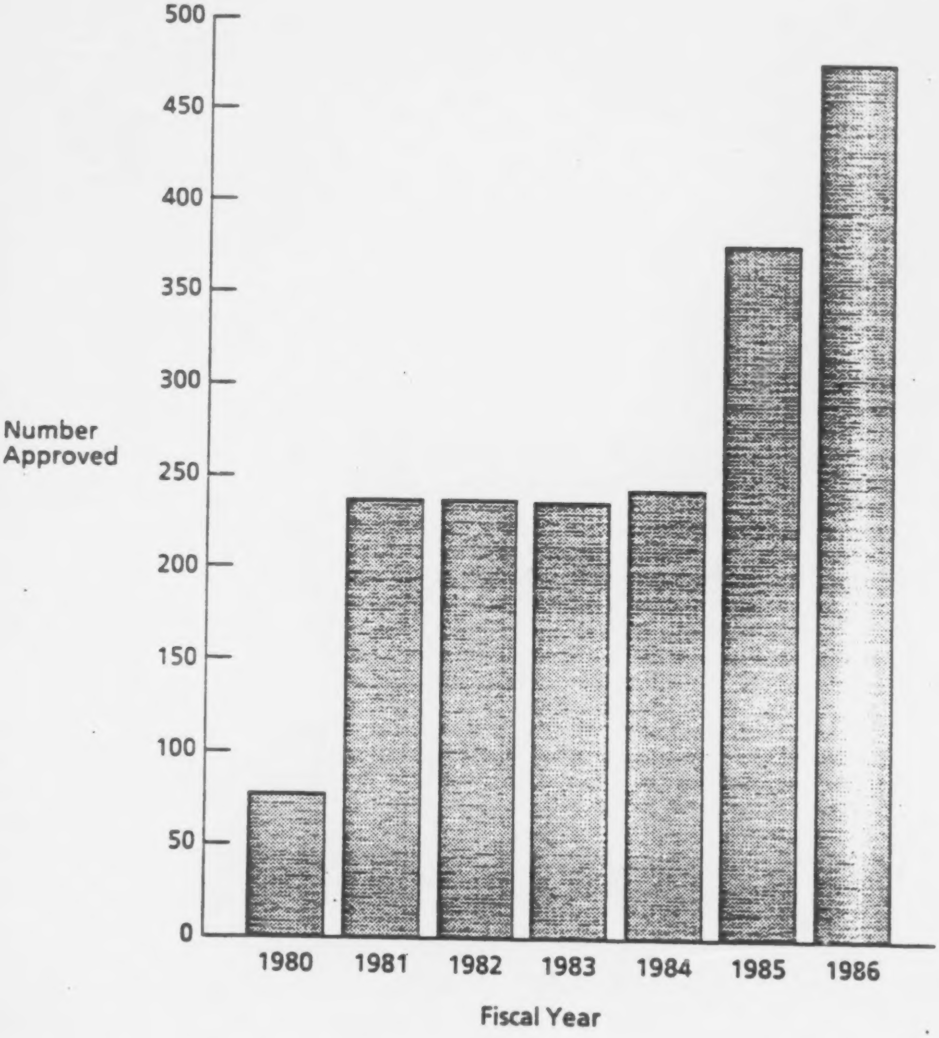
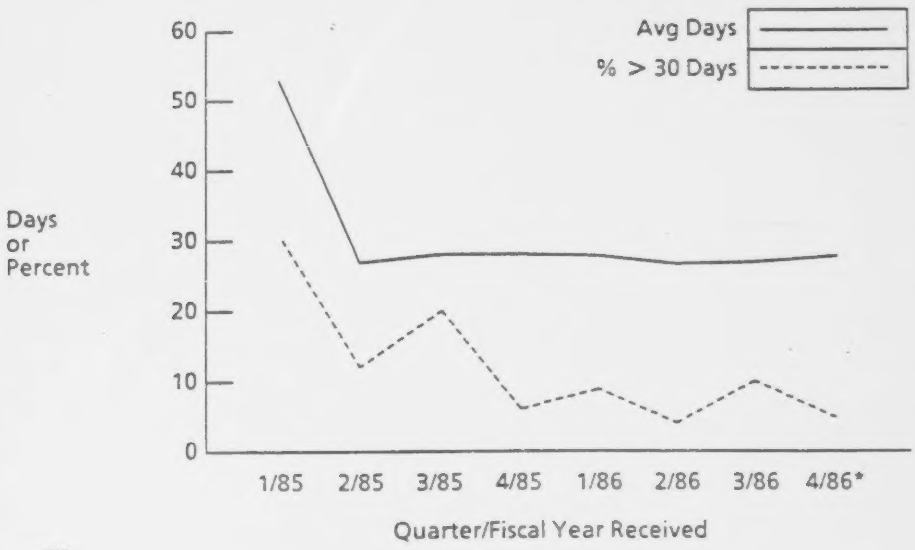
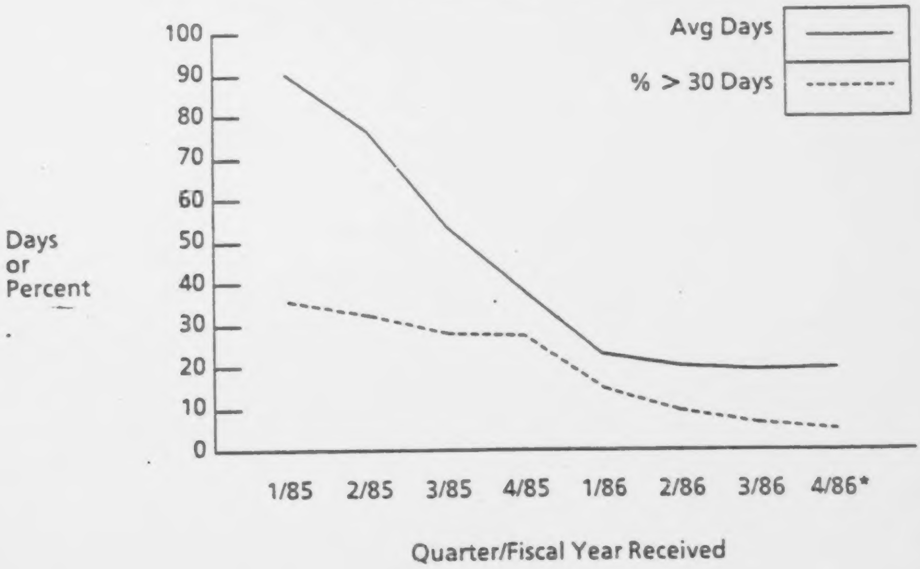


FIGURE 3 - TIMELINESS OF IDE DECISIONS FY 1985 - FY 1986, BY QUARTER OF RECEIPT



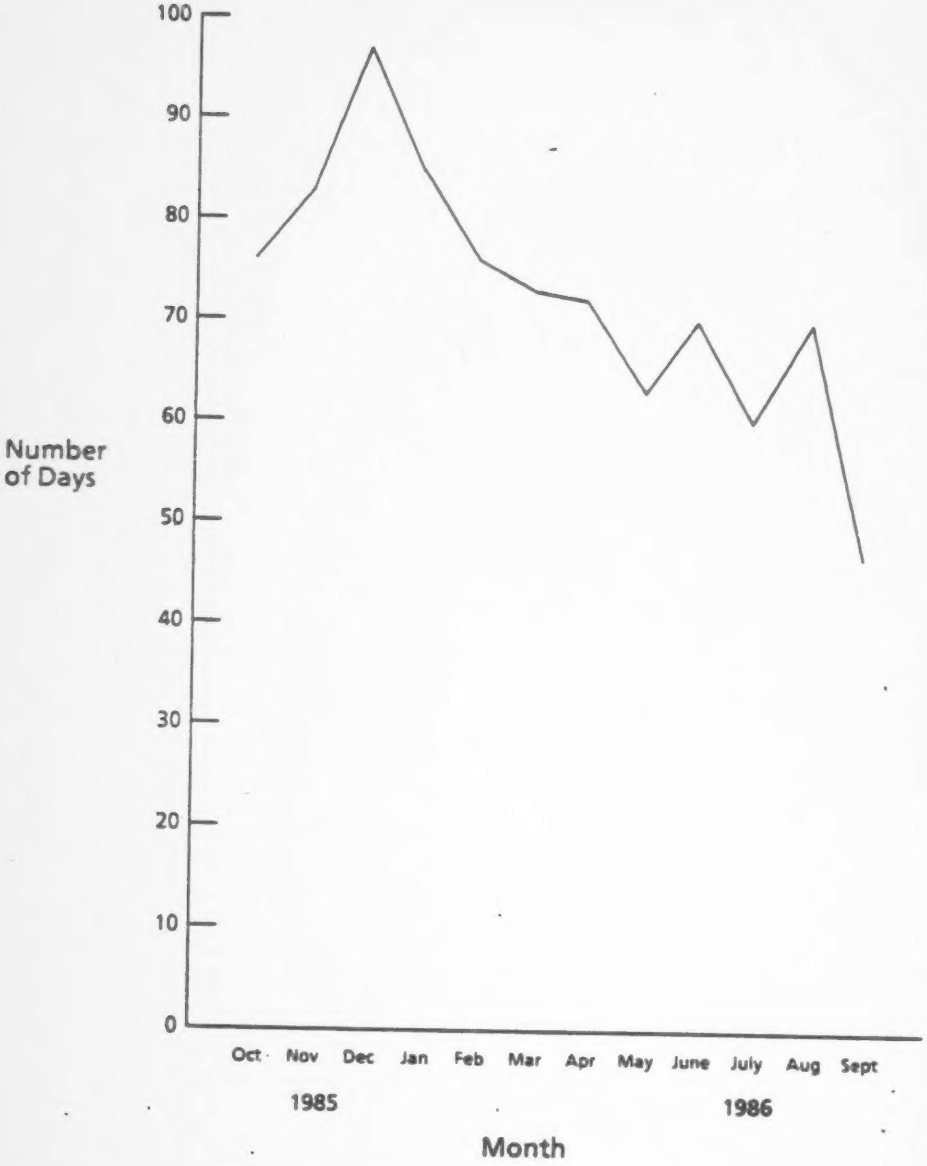
* Based on 43 completed original IDE's out of 46 received during the quarter.

FIGURE 4 - TIMELINESS OF IDE SUPPLEMENT DECISIONS FY 1985 - FY 1986, BY QUARTER OF RECEIPT



* Based on 684 completed IDE Supplements out of 700 received during the quarter.

FIGURE 5 - AVERAGE REVIEW TIMES FOR 510(K)'S
OCTOBER 1985 - SEPTEMBER 1986, BY MONTH



APPENDIX H

FDA's CONGRESSIONAL HEARINGS IN FY 86

DATE	COMMITTEE	SUBJECT
10/10/85	Senate Committee on Labor and Human Resources (Hatch)	Nutrition Labeling
11/7/85	The Republican Study Committee (Dannenmeyer)	AIDS
11/14/85	The Environmental and Energy Study Conference (Gore)	Biotechnology
11/18/85	Subcommittee on Department Operations, Research, and Foreign Agriculture (Bedell), House Committee on Agriculture	Irradiation H.R. 696
1/30/86	House Committee on Energy and Commerce (Dingell)	The Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings)
2/5/86	Subcommittee on Investigations and Oversight (Volkmer), House Committee on Science and Technology	Artificial Hearts
2/10/86	Subcommittee on Health and the Environment (Waxman), House Committee on Energy and Commerce	Field hearing in Santa Monica, California on PCBs and DDT in fish
2/28/86	Senate Committee on Labor and Human Resources (Hatch)	Tylenol Tampering
3/6/86	Senate Special Committee on Aging (Heinz)	Hemodialysis
4/8/86	House Subcommittee on Agriculture, Rural Development, and Related Agencies (Whitten), Committee on Appropriations	Budget
4/16/86	Senate Committee on Labor and Human Resources (Hatch)	AIDS

DATE	COMMITTEE	SUBJECT
4/21/86	House Subcommittee on Investigations and Oversight (Volkmer), Committee on Science and Technology	Artificial Intelligence
4/24/86	House Committee on Science and Technology (Fuqua) - Science Policy Task Force	Bio-Medical Research
4/28/86	House Subcommittee on Health and the Environment (Waxman) Committee on Energy and Commerce	Export - Biotechnology
5/1/86	Subcommittee on Crime, House Committee on the Judiciary	Designer Drugs
5/6/86	Subcommittee on Science, Research, and Technology (Walgren), House Committee on Science and Technology	Alternatives in Animal Research and Testing
5/19/86	Subcommittee on Select Revenue Measures (Rangel), House Committee on Ways and Means	Labeling of nonalcoholic beer and wine
5/22/86	Subcommittee on Intergovernmental Relations and Human Resources (Weiss), House Committee on Government Operations	Merital
5/28/86	Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations	Wine Contamination
6/5/86	Joint hearing before the Subcommittee on Natural Resources, Agriculture Research and Environment (Scheuer), Subcommittee on Science, Research and Technology (Walgren), House Committee on Science and Technology	Biotechnology
6/11/86	Subcommittee on Livestock, Dairy, and Poultry, House Committee on Agriculture	Bovine Growth Hormone

DATE	COMMITTEE	SUBJECT
7/1/86	Subcommittee on Intergovernmental Relations and Human Resources (Weiss), House Committee on Government Operations	Research and Testing of Drugs for AIDS
7/15/86	Subcommittee on Oversight and Investigations (Dingell), House Committee on Energy and Commerce	Drug Diversion H.R. 4820
7/18/86	Senate Committee on Labor and Human Resources	Veterinary ANDAs and Patent Term Restoration (S. 2407)
7/23/86	Joint Subcommittee on Natural Resources, Agriculture Research and Environment, and Subcommittee on Science, Research and Technology, House Committee on Science and Technology	Biotechnology Regulations
7/29/86	Subcommittee on Health and the Environment (Waxman), House Committee on Energy and Commerce	H.R. 5069 Veterinary ANDAs
9/25/86	Subcommittee on Investment, Jobs and Prices, Joint Committee on Economics	Antiseptics

AIDS

Dr. YOUNG. We believe that the 1–AA priority that we have provided for AIDS therapies will be of substantial importance. Additionally, we have made progress in our review programs for both drugs and devices with a substantial improvement in the new device approval process, and an increase in the approval of new devices.

We have also labored vigorously to combat some great problems in tampering, which I would like to just briefly illustrate for you, in a moment, as well as some difficulties with imported foods.

The most significant area that I would like to focus for my introduction, however, is on the disease AIDS. It is a most unusual infectious disease in that it destroys the very immune system that usually protects us from infection.

Designing the therapy for this disease is a difficult task because the natural history of the disease is unknown. We must recognize that at FDA we will be called upon to review a large number of candidate drugs and vaccines, as the epidemic spreads. There are basically three epidemics: The silent epidemic, through which the virus spread throughout the world in the late 1960's and early 1970's; the appearance of the disease in the 1980's; and what we are seeing now as the social epidemic as individuals become more cognizant of the disease. All three are occurring simultaneously.

In a sense, FDA must be prepared to meet this crisis, namely a war on AIDS. If I may be permitted, in a sense we are analogous to a munitions factory during a war. The research developments that are being abundantly supported will provide many observations of ways in which therapy can be developed.

It is FDA's task to manufacture bullets. We must be prepared to take these research developments, implement them and provide therapies to the best of our ability for the nation.

We are also focusing on a new proposal, which is in my testimony, on a treatment IND. This is a concept designed to bring drugs earlier to people who are desperately ill. This is not restricted to AIDS, but instead is focused on meeting the needs of people who have immediate life-threatening and other serious diseases, by providing them access to breakthrough drugs.

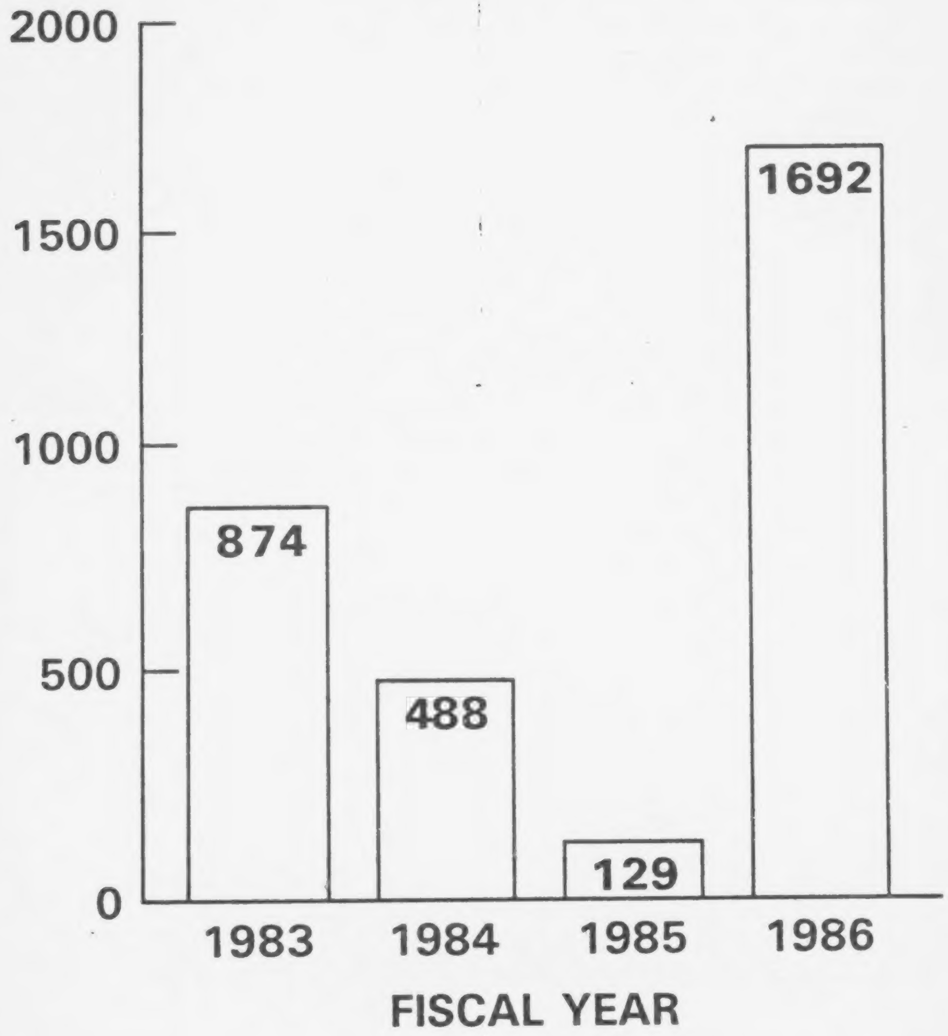
In the area of medical devices, we have had major management improvements, as I have mentioned, and we have reallocated resources to improve product approval.

The United States is among the safest in its food supply within the world, but there is still room for improvement and we are focusing in our new Action Plan—Phase II on foods and food safety. Particularly, we wish to be sure that we can prevent problems that we know are coming in the field of microbial contamination.

Risk assessment continues to be a major area as we focus on de minimis, but probably the key thing that I would like to leave with you, in conclusion, is the focus on our emergency actions.

[The chart follows:]

TAMPERING COMPLAINTS



PRODUCT TAMPERING

Dr. YOUNG. As you can see, tampering events of fiscal year 1983 totaled 874. This included the Tylenol tamperings of October 1982. Tampering events fell in fiscal year 1984 and continued to fall in 1985. In 1986, with the second Tylenol tamperings and subsequent events, you can see a marked increase in the activity that focused on FDA.

There was a period that we were able to manage emergencies and tamperings, within available resources, up until 1986. At which time, however, we experienced almost a doubling in the staff required to deal with these emergencies.

The next chart shows you the scope of public health activities of FDA.

[The chart follows:]

FY 1986

EMERGENCIES, CONSUMER COMPLAINTS AND OTHER MAJOR UNPLANNED WORK

	FTE's	COST
DAIRY PRODUCTS SAFETY	59.6	$ 2,670,000
HEPTACHLOR IN MILK AND CHEESE	30.2	1,353,000
ADULTERATION OF FOODS AND DRUGS	9.5	426,000
CONSUMER COMPLAINTS	176.0	7,885,000
SULFITES	48.4	2,169,000
LISTERIOSIS IN CHEESE	63.5	2,850,000
GLASS IN GERBER AND OTHER BABY FOODS INVESTIGATIONS	31.1	1,394,000
CHERNOBYL INVESTIGATION	4.9	220,000
LEAD AND CADMIUM IN FOODS	2.3	103,000
TYLENOL AND OTHER DRUG TAMPERING INCIDENTS	63.7	2,854,000
ANABOLIC STERIODS	9.9	444,000
KRAFT POLAR BARS	8.3	372,000
TOTAL	507.4	$ 22,740,000

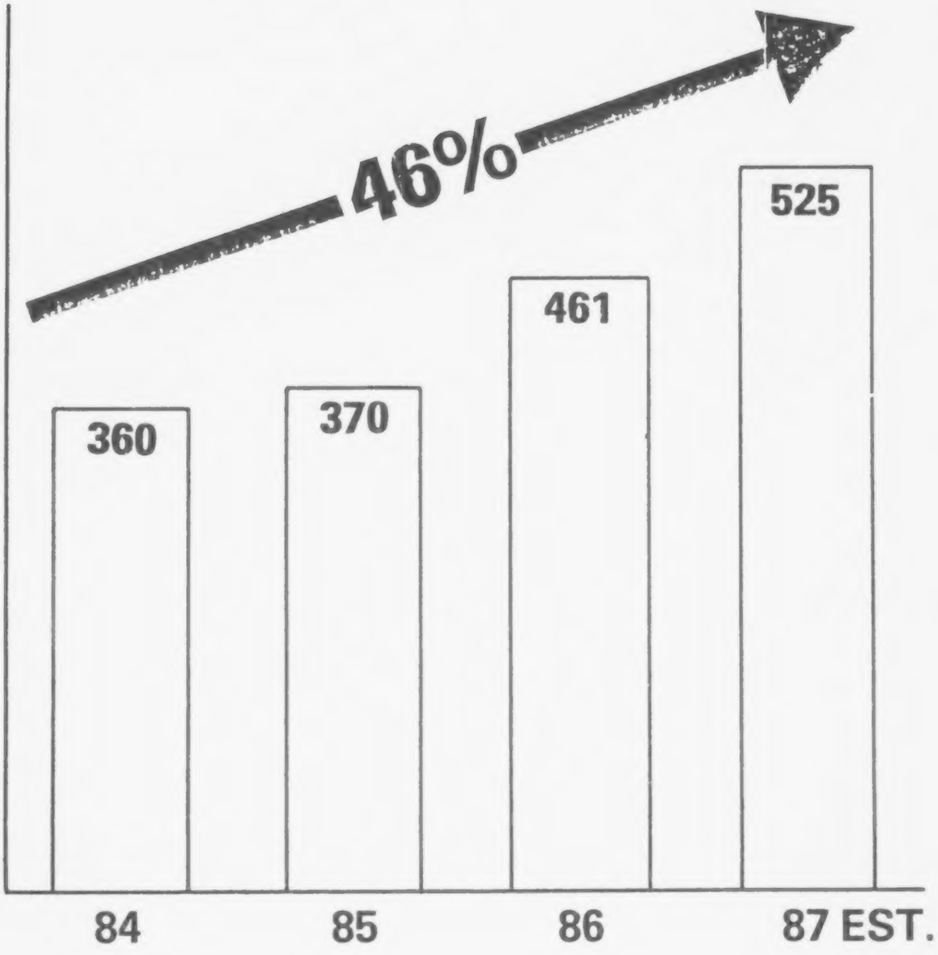
Dr. Young. Basically, we are not only dealing with the tampering emergencies, but we have problems with dairy product safety that consumed more than $2 million and almost 60 staff-years. We also had problems with the Chernobyl accident, in which we screened foods for radioactivity, and then the many tamperings, which as you can see cost in excess of $2.5 million and involved approximately 64 staff-years.

IMPORTS

One of the areas that we have also been worried about, imports, is shown in the next visual

[The chart follows:]

IMPORT FTEs RISING



To meet rising workload, FDA is increasing staff years devoted to imports even though total Agency staffing has been decreasing.

Dr. Young. We feel that there must be a single standard, not a double standard, between domestic and imported products.

We have, therefore, realized that there needs to be a change in our enforcement policy on imports. In the earlier portion of the 20th century, raw materials were imported and manufactured within the United States.

The inspection of plants and factories provided an adequate means to ensure safety. Now, many of the products coming into the United States are finished goods from overseas. We do not inspect those plants. We must rely on wharf inspection and other examinations.

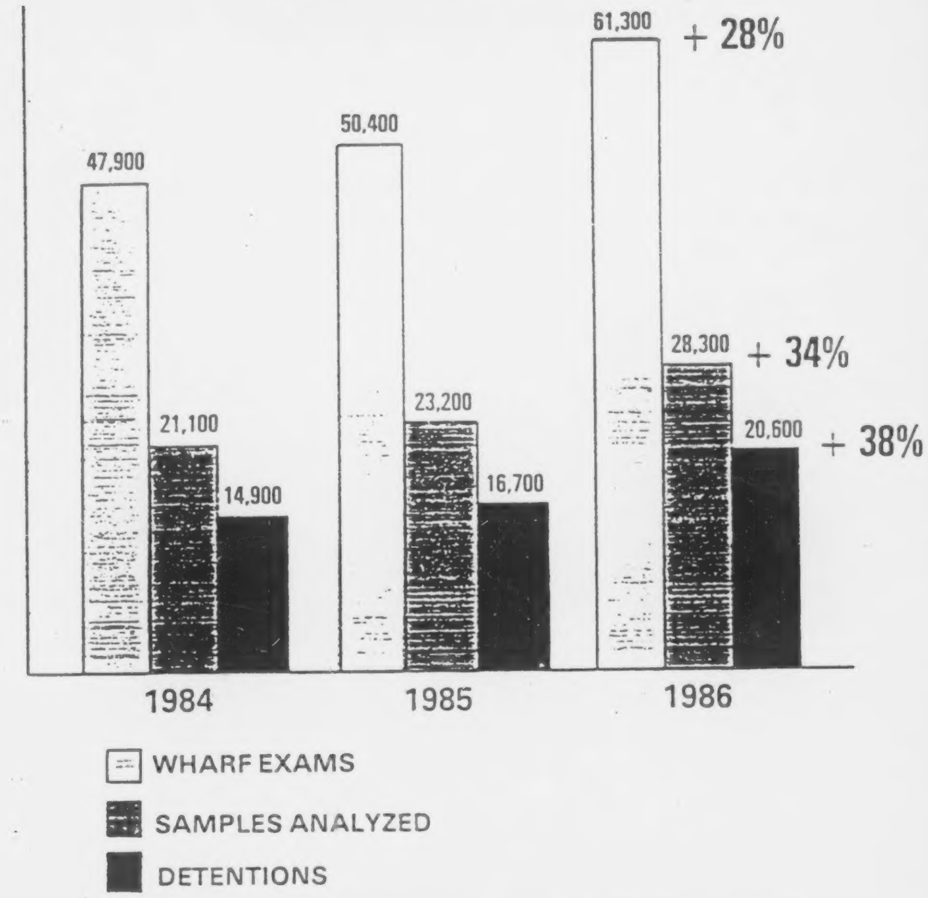
Thus, we have a highly regulated, appropriately regulated domestic industry and foreign industry that brings finished products in that does not have that degree of regulation, if you will. Just yesterday, for example, we found that coming in from Belgium were candies that had a color, Red 10, which had been banned for years within the United States.

Also, within the last week we found benzene-contaminated coconut oil. Many thousands of tons were contaminated with benzene.

This type of planned surveillance has been increased, as you can see, by 46 percent, and the next chart shows that with that increase, we have increased our detentions.

[The chart follows:]

FDA IMPORT ACTIVITIES
1984-1986



86 MAJOR PROBLEMS

- LISTERIA IN IMPORTED SOFT CHEESE
- CHERNOBYL INCIDENT
- THREAT OF POISON IN SRI LANKA TEA

Dr. YOUNG. So, in summary, Mr. Chairman, we face a large number of actions in our protection of the American health, ranging from product approval, to enforcement and prevention. We are a public health agency that focuses on problem identification, problem prevention and problem resolution.

We greatly appreciate the support that this committee, the Congress, and the administration, has provided in helping us meet the needs of the American people.

Thank you, Mr. Chairman.

PREPARED STATEMENT

Senator BURDICK. Thank you, Dr. Young. We have your complete statement and it will be made part of the record.

[The statement follows:]

STATEMENT OF FRANK E. YOUNG

MR. CHAIRMAN, I AM PLEASED TO HAVE THE OPPORTUNITY TO APPEAR BEFORE YOUR SUBCOMMITTEE TODAY TO SUPPORT THE FOOD AND DRUG ADMINISTRATION'S BUDGET REQUEST FOR 1988. I WOULD FIRST LIKE TO INTRODUCE MY COLLEAGUES AT THE TABLE WITH ME.... OTHER MEMBERS OF MY STAFF ARE ALSO PRESENT TO RESPOND, IF NECESSARY, TO SPECIFIC QUESTIONS AND INTERESTS OF THE COMMITTEE.

THIS PAST YEAR HAS BEEN ONE OF BOTH CHALLENGE AND ACCOMPLISHMENT FOR FDA. DURING THE COURSE OF THE YEAR THE AGENCY COMBATTED AN UNPRECEDENTED NUMBER OF PRODUCT TAMPERINGS AND OTHER EMERGENCIES, STRENGTHENED OUR EMPHASIS ON PROBLEMS WITH IMPORTED FOODS, AND CONTINUED TO FOCUS RESOURCES ON DEVELOPING THERAPIES FOR VICTIMS OF AIDS. AT THE SAME TIME THE AGENCY HAS MADE SUBSTANTIAL HEADWAY IN ITS REVIEW OF NEW DRUGS, GENERIC DRUGS, AND MEDICAL DEVICES, AS WELL AS ADVANCES IN THE SCIENCE OF RISK ASSESSMENT. WITH YOUR PERMISSION, I WOULD LIKE TO SUBMIT FOR THE RECORD A SUMMARY OF OUR SIGNIFICANT ACCOMPLISHMENTS FOR FY 1986.

EVEN IN THE MOST NORMAL OF TIMES, FDA'S RESPONSIBILITIES ARE A TALL ORDER. PRODUCTS REGULATED BY FDA ACCOUNT FOR ABOUT TWENTY-FIVE CENTS OF EVERY CONSUMER DOLLAR THAT IS SPENT. PRODUCTS THE AGENCY MUST ASSURE ARE SAFE INCLUDE FOODS, DRUGS, MEDICAL DEVICES, VACCINES, BLOOD PRODUCTS, RADIOLOGICAL PRODUCTS, VETERINARY DRUGS, AND COSMETICS. WE OCCUPY THAT IMPORTANT ARENA OF TECHNOLOGY TRANSFER FROM THE TIME OF DISCOVERY THROUGH BASIC RESEARCH TO THE INTRODUCTION OF PRODUCTS TO THE CONSUMER. THUS WE HAVE A PARTICULARLY BROAD MANDATE WHICH ALSO REQUIRES US TO BE INVOLVED IN EDUCATING CONSUMERS ABOUT THE SAFETY OF THE PRODUCTS WE REGULATE SO THAT THEY CAN PARTICIPATE IN ENSURING THEIR HEALTH. THIS IS PARTICULARLY TRUE WITH PRODUCT TAMPERING. MR. CHAIRMAN, YOU AND OTHER MEMBERS OF THE COMMITTEE RECOGNIZE THE IMPORTANCE OF OUR TASK, AND IT IS IN LARGE PART DUE TO YOUR SUPPORT THAT WE HAVE BEEN ABLE TO ENSURE THE PUBLIC SAFETY IN A MOST CHALLENGING YEAR.

A PRIMARY TOOL IN PREPARING THE AGENCY FOR ITS WORK HAS BEEN THE FDA ACTION PLAN. TO DATE WE HAVE BEGUN 97 PERCENT OF THE MILESTONES OF OUR ORIGINAL ACTION PLAN, AND WE HAVE COMPLETED 86 PERCENT. THE SUBSTANTIVE RESULTS OF THIS EFFORT CAN BE SEEN IN EVERY AREA OF AGENCY ACTIVITIES INCLUDED IN THE PLAN. HOWEVER, INASMUCH AS PASSING TIME GIVES US A BETTER VISION OF THE NEEDS OF THE FUTURE, AND A FLEXIBLE PLAN IS A MORE USEFUL PLAN, I AM INITIATING ACTION PLAN PHASE 2 TO IMPROVE ON THE ORIGINAL JULY 1985 ACTION PLAN AND BUILD ON ITS SUCCESS.

IN ORDER TO PLACE OUR BUDGET REQUEST IN PERSPECTIVE, I WOULD LIKE TO REVIEW BRIEFLY THE DEMANDS ON THE AGENCY AND OUR ACCOMPLISHMENTS IN RESPONSE TO THOSE DEMANDS. WITH YOUR PERMISSION, I WILL DISCUSS OUR ACTIVITIES UNDER THE FOLLOWING HEADINGS:

- NEW PRODUCT EVALUATION
- PROBLEMS IN FOOD SAFETY
- RISK ASSESSMENT
- RISK MANAGEMENT
- IMPACT OF NEW TECHNOLOGIES
- BUDGET REQUEST SUMMARY

NEW PRODUCT EVALUATION

HUMAN DRUGS AND BIOLOGICALS

ONE OF THE PRINCIPAL FOCUSES AT FDA IN RECENT YEARS, HAS BEEN OUR ATTEMPT TO SPEED THE APPROVAL OF SAFE AND EFFECTIVE DRUGS AND BIOLOGICALS, WHILE AT THE SAME TIME IMPROVING THE QUALITY OF OUR REVIEW PROCESS. REVISIONS IN THE REGULATIONS FOR NEW DRUG APPLICATIONS, AND NEW GUIDELINES TO HELP MANUFACTURERS ORGANIZE AND STREAMLINE APPLICATIONS, AS WELL AS OTHER MANAGEMENT

INITIATIVES WE'VE UNDERTAKEN ARE EXPECTED TO RESULT IN FURTHER REDUCTIONS IN REVIEW TIME OVER THE NEXT FEW YEARS.

WE ARE ENCOURAGED BY THE FACT THAT DURING CALENDAR YEAR 1986, FDA APPROVED IN EXCESS OF 800 DRUG AND BIOLOGICAL PRODUCTS, INCLUDING 26 TOTALLY NEW AND INNOVATIVE PRODUCTS. MAJOR DRUG APPROVALS WERE ETRETINATE, A VITAMIN A DERIVATIVE FOR PSORIASIS; AND CLOFAZAMINE, WHICH IS DESIGNATED AS AN ORPHAN DRUG FOR TREATMENT OF LEPROSY. OTHER IMPORTANT APPROVALS WERE BUSPIRONE, AN ANTIANXIETY DRUG WITHOUT THE SEDATING EFFECT OF MOST SUCH DRUGS; AZTREONAM, THE FIRST OF A NEW CLASS OF ANTIBIOTICS; AND ENCAINIDE HCL, AN ANTIARRHYTHMIC DRUG FOR SERIOUS VENTRICULAR ARRHYTHMIAS. MAJOR BIOLOGICAL APPROVALS LAST YEAR WERE THREE BIOTECHNOLOGY BREAKTHROUGHS-- TWO ALPHA INTERFERON PREPARATIONS TO TREAT A RARE ADULT LEUKEMIA, A GENETICALLY ENGINEERED VACCINE FOR HEPATITIS B, AND THE FIRST PARENTERAL MONOCLONAL ANTIBODY FOR THERAPEUTIC USE TO REVERSE ACUTE KIDNEY TRANSPLANT REJECTIONS.

OVERALL, FDA APPROVED 98 NEW DRUG APPLICATIONS, AS WELL AS A NUMBER OF IMPORTANT NEW DRUG CLAIMS FOR PREVIOUSLY APPROVED DRUGS. THESE INCLUDE THE USE OF ETOPOSIDE TO TREAT SMALL CELL LUNG CANCER, TAMOXIFEN AS AN ADJUVANT THERAPY IN POST-MENOPAUSAL BREAST CANCER, AND CALCITRIOL FOR TREATMENT OF BONE MINERALIZATION DEFECTS IN RENAL DIALYSIS PATIENTS.

FROM THIS SUMMARY, YOU CAN SEE THAT A NUMBER OF NEW IMPORTANT THERAPIES ARE NOW AVAILABLE FOR THE RELIEF OF MILLIONS OF AMERICANS. HOWEVER, FURTHER EFFORTS ARE ESSENTIAL IN THE NEW DRUG AREA TO BUILD ON THE PROGRESS WE'VE ALREADY MADE.

AT THIS TIME WE BELIEVE THAT THE NUMBERS OF FDA REVIEWING STAFF AND THE QUALITY OF THE NEW DRUG APPLICATIONS WE RECEIVE ARE THE TWO MOST CRITICAL RATE LIMITING FACTORS IN THE REVIEW OF NEW DRUG APPLICATIONS. ACCORDINGLY, SINCE COMING TO FDA I HAVE REALLOCATED

OVER 50 POSITIONS FROM LOWER PRIORITY FUNCTIONS TO THIS ACTIVITY. IN ADDITION, WE ARE WORKING ACTIVELY WITH THE INSTITUTE OF MEDICINE, THE NATIONAL INSTITUTES OF HEALTH, THE AMERICAN MEDICAL ASSOCIATION AND THE PHARMACEUTICAL MANUFACTURERS ASSOCIATION TO RECRUIT, THROUGH FELLOWSHIP PROGRAMS AND OTHER MECHANISMS, THE KIND OF QUALITY MEDICAL AND SCIENTIFIC REVIEW STAFF NECESSARY TO MEET AN IMPORTANT AND GROWING WORKLOAD.

IN ADDITION, TO IMPROVE THE QUALITY OF THE APPLICATIONS WE RECEIVE, DURING THIS PAST YEAR WE HAVE ISSUED NEW GUIDELINES AND REGULATIONS AND SPONSORED NUMEROUS SEMINARS AND MEETINGS ON THE DATA NECESSARY TO SUPPORT A NEW DRUG APPLICATION AND HOW IT CAN BE ORGANIZED AND PRESENTED TO FACILITATE OUR REVIEW. WE HAVE ALSO INITIATED EFFORTS INTERNALLY TO MAKE THIS PROCESS WORK BETTER, INCLUDING IMPROVED INFORMATION TRACKING SYSTEMS, BETTER EQUIPMENT AND SPACE FOR OUR STAFF, AND BETTER OVERALL ADMINISTRATIVE ATTENTION TO THE NEEDS OF THIS IMPORTANT PROGRAM. AND FINALLY, WE HAVE UNDERTAKEN A NUMBER OF OTHER INITIATIVES, INCLUDING BETTER COMMUNICATION WITH THE PUBLIC TO PROMOTE UNDERSTANDING OF THIS PROCESS AND MAINTAIN PUBLIC CONFIDENCE IN IT.

WE ARE, OF COURSE, SENSITIVE TO THE FACT THAT STEPS TAKEN TO ADJUST THIS PROCESS MUST BE OBJECTIVE AND BALANCED. OUR GOAL IS TO SEARCH FOR THAT POINT AT WHICH THE FLOW OF GENUINE THERAPEUTIC ADVANCES IS MAXIMIZED, THE RISK OF EXPOSING HUMANS TO UNSAFE OR INEFFECTIVE PRODUCTS IS MINIMIZED, AND THE PUBLIC'S CONFIDENCE IN FDA'S ABILITY TO MAKE SOUND DECISIONS ON ITS BEHALF IS MAINTAINED. FDA'S REQUEST FOR AN INCREASE OF $1.6 MILLION IN 1988 AND 32 FTES SEEKS TO EXPEDITE NEW DRUG REVIEW WHILE MAINTAINING THIS BALANCE.

I DO NOT PROMISE THIS COMMITTEE A "QUICK FIX" BECAUSE I THINK SUCH SOLUTIONS ARE OFTEN MORE SUPERFICIAL THAN SUBSTANTIVE, BUT I DO PROMISE A FIRM AND CONTINUED COMMITMENT TO REDUCING REVIEW TIME WITHOUT COMPROMISING THE QUALITY OF OUR REVIEW -- AND I BELIEVE

THAT SUCH AN EFFORT WILL PRODUCE POSITIVE RESULTS THAT WE CAN ALL BE PROUD OF AND WHICH WILL ENDURE THE TEST OF TIME. AT THE SAME TIME, WE CONTINUE TO PRESS TOWARDS THE GOAL OF TWELVE MONTHS FOR REVIEW, INSTEAD OF THE PRESENT 25 MONTHS.

IN THIS EFFORT, WE ARE WORKING ON A SEPARATE LEGISLATIVE PROPOSAL TO PROVIDE FDA WITH THE AUTHORITY TO CHARGE USER FEES FOR THE REVIEW OF MANUFACTURER'S APPLICATIONS TO MARKET NEW DRUGS. AS PROPOSED IN OUR BUDGET REQUEST, COLLECTIONS OF UP TO $25.8 MILLION WOULD BE MADE AVAILABLE TO SUPPORT NEW DRUG REVIEW ACTIVITIES, INCLUDING THE ADDITIONAL $1.6 MILLION REQUESTED FOR 1988. WE ARE FULLY AWARE OF PAST CONGRESSIONAL GUIDANCE ON USER CHARGES, AND THAT IS WHY WE WILL BE SUBMITTING A SEPARATE LEGISLATIVE PROPOSAL TO ALLOW FOR FULL CONGRESSIONAL REVIEW OF THE ISSUE.

AIDS

THE FOOD AND DRUG ADMINISTRATION LAST YEAR ALSO PLAYED A KEY PART IN THE PUBLIC HEALTH SERVICE'S EFFORTS TO FIGHT THE NATION'S NUMBER ONE PUBLIC HEALTH ENEMY -- AIDS. LAST YEAR, FDA INTRODUCED A NEW 1-AA PRIORITY DESIGNATION FOR REVIEW OF AIDS-RELATED DRUGS, AND THE AGENCY MOBILIZED AND ALLOCATED RESOURCES TOWARDS FACILITATING THE SWIFT DEVELOPMENT AND APPROVAL OF ANY THERAPY FOUND TO BE PROMISING FOR THE TREATMENT OF AIDS AND AIDS-RELATED CONDITIONS.

THE FIRST APPLICATION OF OUR NEW 1-AA DESIGNATION FOR NEW DRUGS WAS TO THE DRUG AZIDOTHYMIDINE (AZT). PRECLINICAL STUDIES CONDUCTED IN OUR LABORATORIES AND THOSE AT THE NATIONAL CANCER INSTITUTE WERE AMONG THE FIRST TO SHOW AZT'S INHIBITORY EFFECTS ON THE HTLV-III VIRUS, THE AGENT WHICH CAUSES AIDS. IN JUNE, 1985, FDA APPROVED THE FIRST CLINICAL TESTING OF THE DRUG WITHIN FIVE DAYS OF RECEIVING THE APPLICATION. WHEN EARLY CLINICAL TESTS WERE PROMISING, FDA APPROVED THE EXPANSION OF CLINICAL TRIALS WHICH

LED, IN LATE SEPTEMBER OF LAST YEAR, TO FDA APPROVAL OF A TREATMENT PROTOCOL ALLOWING WIDER USE OF THE DRUG. FDA APPROVED THAT PROTOCOL IN ONE WEEK.

AT A PRESS CONFERENCE ANNOUNCING THE TREATMENT PROTOCOL, DR. DAVID BARRY REPRESENTING BURROUGHS WELLCOME (THE MANUFACTURER OF THE DRUG) SAID:

> "SINCE THE BEGINNING OF OUR AIDS RESEARCH, THE FOOD AND DRUG ADMINISTRATION, THE NATIONAL CANCER INSTITUTE, AND RESEARCH INSTITUTIONS HAVE BEEN WORKING EXTENSIVELY ON THIS PROJECT. IT HAS BEEN A STAGGERING UNDERTAKING, BUT ONE IN WHICH THE CLOSE COLLABORATION BETWEEN PRIVATE INITIATIVE AND GOVERNMENT COOPERATION HAS PROVEN VERY EFFECTIVE IN SPEEDING THE PROJECT ALONG AS RAPIDLY AS IT'S REALISTICALLY POSSIBLE. AFTER LESS THAN 2 YEARS, WE ARE AT THE POINT WE WOULD NORMALLY BE AT AFTER 4 TO 5 YEARS."

ON MARCH 20, 1987, FDA APPROVED THE NEW DRUG APPLICATION FOR THIS DRUG. FDA LABORATORIES CONTINUE TO PROVIDE TECHNOLOGICAL SUPPORT BY MEETING FREQUENTLY WITH OTHER MANUFACTURERS OF CANDIDATE VACCINES IN PRE-IND MEETINGS IN AN EFFORT TO ASSURE EXCHANGE OF INFORMATION THAT WILL FACILITATE EXPEDITIOUS PRECLINICAL AND CLINICAL DEVELOPMENT AND IND REVIEW.

THE DIFFERENCE BETWEEN OUR APPROVAL TIME FOR AIDS RELATED THERAPIES AND OTHER THERAPIES IS SIGNIFICANT. WITH AIDS DRUGS THERE IS CONSTANT COMMUNICATION WITH COMPANIES DEVELOPING NEW THERAPIES DURING THE INVESTIGATIONAL NEW DRUG PHASE, AND THE TEAM OF REVIEWERS IS READY AND AVAILABLE WHEN THE APPLICATION ARRIVES. THIS IS IN CONTRAST TO DELAYS THAT OTHER APPLICATIONS RECEIVE AS THEY WAIT IN LINE FOR A REVIEWING TEAM. TO CONTINUE TO PROVIDE THIS HIGH LEVEL OF SUPPORT FOR AIDS RESEARCH IN THE FACE OF A GROWING WORKLOAD, FDA NEEDS AN ADDITIONAL $1.0 MILLION, INCLUDING

22 STAFFYEARS, IN 1988. WITHOUT THE INCREASE IN PERSONNEL REQUESTED, DELAYS COULD OCCUR.

AVAILABILITY OF INVESTIGATIONAL NEW DRUGS

AS OUR HANDLING OF NEW THERAPIES FOR AIDS DEMONSTRATES, WE ARE SENSITIVE TO THE NEED TO MAKE AVAILABLE PROMISING NEW DRUGS TO DESPERATELY ILL PATIENTS AS EARLY IN THE DRUG DEVELOPMENT PROCESS AS POSSIBLE. THEREFORE, WE HAVE BEEN FOCUSING ON WAYS THAT WE CAN INCREASE PATIENT ACCESS TO PROMISING NEW PRODUCTS IN THE FORM OF TREATMENT INDs -- OR INVESTIGATIONAL NEW DRUG EXEMPTIONS. IN CASES SUCH AS THE NEW AIDS DRUG AZT, BECAUSE THE ENTIRE DRUG DEVELOPMENT PROCESS CAN TAKE PRECIOUS TIME TO COMPLETE EVEN AT ITS BEST, FDA ENCOURAGED THE USE OF TREATMENT PROTOCOLS TO PROVIDE NEEDY PATIENTS NEW PRODUCTS THAT HAVE SHOWN SOME EVIDENCE OF EFFECTIVENESS AND SAFETY EARLY IN THE INVESTIGATIONAL STAGES. BY PROVIDING THE AVAILABILITY OF AZT THROUGH DISTRIBUTION UNDER A TREATMENT IND, MORE THAN 3,200 AIDS PATIENTS RECEIVED THIS DRUG PENDING FDA'S REVIEW OF THE MARKETING APPLICATION. IN CASES SUCH AS THESE, WHILE WE STRIVE TO BE RESPONSIVE TO THE NEEDS OF THE PATIENT, WE ALSO ARE AWARE OF THE DANGERS IN ACTING PREMATURELY. NONETHELESS, WE MUST BE SURE THAT WE ARE DOING EVERYTHING POSSIBLE TO GET PROMISING AIDS-RELATED AND OTHER SIGNIFICANT THERAPIES TO AS MANY PATIENTS AS REASONABLY POSSIBLE AS SOON AS WE HAVE ENOUGH DATA TO MAKE THIS JUDGMENT. THIS IS ESPECIALLY TRUE WHERE THE DISEASE IS IMMEDIATELY LIFE-THREATENING OR SERIOUS AND NO SATISFACTORY ALTERNATIVE TREATMENT EXISTS. I AM PLEASED TO ANNOUNCE THAT ON MARCH 20, 1987, WE PUBLISHED PROPOSED NEW RULES ON INVESTIGATIONAL NEW DRUGS THAT WILL, AMONG OTHER IMPROVEMENTS TO THE PROCESS, MAKE INVESTIGATIONAL DRUGS AVAILABLE SOONER TO THESE PATIENTS WHO HAVE LIFE-THREATENING OR OTHER SERIOUS DISEASES FOR WHICH NO ALTERNATIVE THERAPIES ARE AVAILABLE.

Orphan Products

Orphan products represent another aspect of drug development, an area that remains one of the Agency's highest priorities. I am happy to report that our efforts in this area have been fruitful, thanks in a large part to the concern and support of this Subcommittee. Let me cite one example of orphan product development. During 1986 FDA approved trientine hydrochloride for use in treating Wilson's disease, a potentially fatal genetic disorder in which the body cannot metabolize dietary copper. Penicillamine has been available to treat Wilson's disease for 30 years; however, a subgroup of patients with the disease cannot tolerate penicillamine. This subgroup will now have access to effective therapy.

Overall we approved seven New Drug Applications for orphan products in calendar year 1986. We gave official "orphan" designation to 44 products. More recently we gave "orphan" designation to the 100th different compound. This designation entitles the sponsor to tax credits for clinical research expenses as well as eligibility for exclusive marketing approval status.

In 1986, we awarded nearly $2.9 million in both new grants and continuations of prior projects for studies of orphan products, including 21 new research grant and the continuation 12 ongoing clinical investigations. I would note that, in addition to drugs, six of our grants were made for studies that promise to bring useful orphan medical devices to the market. We intend to award $3.5 million of FDA's funds for such grants in 1987, and $3.6 million in 1988, which will even further expand this important effort. We are strongly committed to our orphan drug program and have been impressed that the granting of only a few millions of dollars has greatly increased our emphasis on the development of

CURES TO RARE DISEASES. WE LOOK FORWARD TO YOUR CONTINUED SUPPORT OF THIS MOST IMPORTANT GRANT PROGRAM.

OVER-THE-COUNTER DRUGS

IN THE OVER-THE-COUNTER (OTC) DRUG AREA, FDA ISSUED IN MAY A FINAL RULE PROVIDING MANUFACTURERS WITH FLEXIBILITY IN LABELING LANGUAGE USED TO DESCRIBE THE INTENDED USE OF AN OTC PRODUCT. BEFORE, THE AGENCY'S "EXCLUSIVITY" POLICY PERMITTED ONLY OFFICIAL LANGUAGE APPROVED BY FDA TO BE USED ON AN OTC DRUG LABEL. THE NEW RULES FREE MANUFACTURERS TO USE THEIR OWN WORDS TO DESCRIBE AN OTC DRUG'S INTENDED USE, SO LONG AS THE ALTERNATIVE WORDING IS TRUTHFUL AND NOT MISLEADING. FDA BELIEVES THE PUBLICATION OF THIS REGULATION WILL ACCELERATE THE PACE OF THE AGENCY'S DEVELOPMENT OF OTC MONOGRAPHS IN THE FUTURE.

ANOTHER NONPRESCRIPTION LABELING CHANGE IMPLEMENTED IN 1986 WAS THE REQUIREMENT FOR CERTAIN ASPIRIN-CONTAINING OTC DRUG PRODUCTS TO BE LABELED WITH A WARNING ABOUT THE POSSIBLE ASSOCIATION BETWEEN THE USE OF ASPIRIN AND THE INCIDENCE OF REYE SYNDROME, A RARE BUT SOMETIMES FATAL DISEASE. FDA OFFICIALS ARE COOPERATING CLOSELY WITH THE CENTERS FOR DISEASE CONTROL ON ADDITIONAL STUDIES ON THIS MATTER. ADDITIONALLY, FDA PUBLISHED DURING 1986 A NUMBER OF IMPORTANT OTC MONOGRAPHS UNDER THE GENERAL UMBRELLA OF THE OTC REVIEW. THESE INCLUDED TENTATIVE FINAL MONOGRAPHS FOR: EXOCRINE PANCREATIC INSUFFICIENCY DRUG PRODUCTS; AND DANDRUFF, SEBORRHEIC DERMATITIS, AND PSORIASIS DRUG PRODUCTS. THEY ALSO INCLUDED FINAL MONOGRAPHS FOR ANTHELMINTIC DRUG PRODUCTS AND TOPICAL OTIC DRUG PRODUCTS -- DRUG PRODUCTS FOR USE IN THE EAR.

GENERIC DRUG APPROVALS

IN THE AREA OF GENERIC DRUGS, FDA POSTED A RECORD NUMBER OF APPROVALS IN FISCAL YEAR 1986 -- 616 PRODUCTS, AS COMPARED WITH

389 IN 1985 -- LARGELY MADE POSSIBLE BY THE DRUG PRICE COMPETITION AND PATENT TERM RESTORATION ACT OF 1984. THAT LAW MADE IT POSSIBLE FOR FDA TO APPROVE GENERIC PRODUCTS ON THE BASIS OF DEMONSTRATING BIOEQUIVALENCY IN COMPARING THE GENERIC AND ORIGINAL BRAND-NAME PRODUCT. SINCE THE LAW WAS PASSED 61 DIFFERENT DRUGS ARE NOW AVAILABLE TO THE CONSUMER IN GENERIC VERSIONS FOR THE FIRST TIME, THEREBY PROVIDING THE INCREASED COMPETITION FOSTERED BY THIS ACT. WE ARE ALSO CONTINUING OUR EFFORTS IN SUPPORT OF THE PATENT AND TRADEMARK OFFICE, TO EXPEDITE THE PROCESSING OF PATENT EXTENSIONS AS PROVIDED BY THAT ACT, TO ASSURE THE INTENDED BENEFIT TO INNOVATIVE FIRMS.

MEDICAL DEVICE EVALUATION

IN THE REVIEW OF MEDICAL DEVICE APPLICATIONS, WE HAVE MADE EXTRAORDINARY PROGRESS ENHANCING PRODUCTIVITY WHILE INCREASING THE QUALITY OF THE REVIEW EVALUATION PROCESS. IN 1986, A RECORD 72 ORIGINAL PREMARKET APPROVAL APPLICATIONS (PMAS) WERE APPROVED, COMPARED TO 37 IN 1985. FDA REDUCED PMAS UNDER ACTIVE REVIEW FROM 103 TO 63. AT THE SAME TIME, A RECORD NUMBER OF PMA SUPPLEMENTAL APPLICATIONS WERE APPROVED IN 1986, 477, COMPARED TO 377 APPROVED IN 1985. FOR INVESTIGATIONAL DEVICE EXEMPTION APPLICATIONS (IDES), THE AVERAGE REVIEW TIME WAS REDUCED BY 24%, AND FOR IDE SUPPLEMENTS, THE AVERAGE REVIEW TIME WAS REDUCED BY 36% IN 1986. FDA ACHIEVED THESE IMPROVEMENTS BY INCREASED ADMINISTRATIVE EFFICIENCIES AND BY THE INTERNAL REALLOCATION OF 22 PERSONNEL FROM OTHER AGENCY PROGRAMS, UNDER THE IMPETUS OF THE FDA ACTION PLAN.

FDA EXPECTS THE EFFICIENCY OF THE DEVICE REVIEW PROCESS TO IMPROVE FURTHER AS MANUFACTURERS TAKE ADVANTAGE OF THE SPECIFIC GUIDANCE PROVIDED IN THE NEWLY PUBLISHED PREMARKET APPROVAL REGULATIONS. FDA HOPES TO MAKE SOME OTHER SPECIFIC CHANGES TO THE REVIEW PROCESS THAT WILL REDUCE UNNECESSARY APPLICATION SUBMISSIONS AND SHORTEN REVIEW TIME. HOWEVER, OUR WORKLOAD IN THIS AREA CONTINUES

TO GROW BEYOND THE CAPABILITY OF AGENCY MANAGEMENT TO MAKE ADJUSTMENTS THROUGH ADMINISTRATIVE EFFICIENCIES AND REASSIGNMENT OF PERSONNEL. THEREFORE WE HAVE INCLUDED IN OUR REQUEST AN INCREASE OF $600,000 TO PROVIDE 12 STAFFYEARS TO ENABLE US TO KEEP UP WITH THE WORK WHILE WE CONTINUE TO STREAMLINE THE PROCESS.

AS WITH NEW DRUGS, MANUFACTURERS OF NEW MEDICAL DEVICES CLEARLY BENEFIT FROM FDA'S REVIEW ACTIVITIES. THEREFORE, IN OUR LEGISLATIVE PROPOSAL FOR USER FEES, WE ARE INCLUDING THE AUTHORITY TO CHARGE FEES FOR FDA'S REVIEW OF MANUFACTURER'S APPLICATIONS TO MARKET MEDICAL DEVICES. AS PROPOSED IN OUR BUDGET REQUEST, COLLECTIONS OF UP TO $8 MILLION WOULD BE MADE AVAILABLE TO SUPPORT DEVICE REVIEW ACTIVITIES, INCLUDING THE ADDITIONAL $600,000 REQUESTED FOR 1988.

ANIMAL DRUG EVALUATION

IN ADDITION TO OUR CRITICAL RESPONSIBILITIES IN REVIEWING NEW DRUGS AND DEVICES FOR MEDICAL TREATMENT, ANOTHER ACTIVITY THAT HAS TREMENDOUS IMPACT BOTH ON CONSUMERS AND ON THE AGRICULTURAL INDUSTRY IS OUR REVIEW AND SURVEILLANCE OF ANIMAL DRUGS AND FEEDS. THESE ACTIVITIES ARE IMPORTANT TO THE PUBLIC NOT ONLY BECAUSE THEY MINIMIZE HEALTH HAZARDS THAT THE CONSUMER CANNOT ASSESS, BUT ALSO BECAUSE THEY ENCOURAGE PROPER NUTRITION BY ASSURING A SAFE AND WHOLESOME NATIONAL MEAT, MILK, AND EGG SUPPLY. FDA'S EFFORTS ARE ALSO IMPORTANT BECAUSE OF THIS NATION'S ROLE AS A WORLD LEADER IN THE USE OF ANIMAL DRUGS IN THE PRODUCTION OF LIVESTOCK, POULTRY, AND OTHER FOOD ANIMALS.

FDA HAS MADE SIGNIFICANT PROGRESS IN IMPROVING PRODUCTIVITY IN THE REVIEW AND PROCESSING OF NEW ANIMAL DRUG APPLICATIONS AND INVESTIGATIONAL NEW DRUG APPLICATIONS. BY ADAPTING TO ANIMAL DRUG APPLICATIONS SEVERAL CHANGES MADE IN HUMAN DRUG REGULATIONS, FDA

HOPES TO FURTHER ENHANCE BOTH THE QUALITY AND TIMELINESS OF INDUSTRY SUBMISSIONS AND AGENCY REVIEW OF APPLICATIONS.

A MAJOR CONCERN IN THIS ACTIVITY IS TO ENSURE THAT POTENTIALLY HARMFUL DRUG RESIDUES DO NOT REMAIN IN FOODS, AND THE AGENCY HAS MADE SUBSTANTIAL PROGRESS IN THIS EFFORT. FDA-APPROVED VETERINARY DRUGS -- SOME 1,500 -- ACCOUNT FOR 90 PERCENT OF ALL MARKETED DRUGS USED IN FOOD ANIMALS. THOSE UNAPPROVED PRODUCTS WHICH FDA HAS NOT SOUGHT TO REMOVE FROM THE MARKET INCLUDE VITAMINS, MINERALS AND OTHER SUBSTANCES, SUCH AS ANIMAL LINIMENTS, THAT HAVE NO KNOWN RISK TO HUMANS, AS WELL AS SOME MEDICATIONS AND OTHER PRODUCTS FOR NON-FOOD ANIMALS. OF COURSE, THE AGENCY WILL CONTINUE ITS ENFORCEMENT EFFORTS AGAINST THOSE CASES WHERE EITHER APPROVED OR UNAPPROVED DRUGS ARE USED IN WAYS THAT MAY PRESENT A HEALTH RISK.

PROBLEMS IN FOOD SAFETY

WHILE THE ACTION PLAN HAS BEEN KEY TO OUR SUCCESSES IN THE AREA OF PRODUCT REVIEW, IT HAS ALSO BEEN BEEN INSTRUMENTAL IN MANAGING FDA'S RESPONSE TO THE PROBLEMS IN FOOD SAFETY. FOOD SAFETY WILL BE FEATURED AS A MAJOR FOCUS OF PHASE 2 OF FDA'S ACTION PLAN.

FOODBORNE ILLNESS

A MAJOR PART OF THIS INITIATIVE WILL BE THE DEVELOPMENT OF A STRONG PROGRAM RELATED TO FOODBORNE ILLNESS. FDA SCIENTISTS HAVE ESTIMATED THAT ROUGHLY ONE-THIRD OF ALL DIARRHEAL EPISODES IN THE UNITED STATES - SOMEWHERE BETWEEN 24 MILLION AND 81 MILLION CASES ANNUALLY - ARE OF FOODBORNE ORIGIN. FOR MOST OF US, THESE EPISODES ARE ONLY A SHORT-TERM NUISANCE, BUT FOR THE VERY YOUNG, THE VERY OLD, AND THOSE WHOSE IMMUNE SYSTEMS ARE COMPROMISED, IT CAN BE A MUCH MORE SERIOUS DISEASE. IN 1985, SALMONELLA CONTAMINATED MILK FROM A DAIRY JUST OUTSIDE CHICAGO CAUSED TWO

DEATHS AND OVER 4,000 HOSPITALIZATIONS. LISTERIA CONTAMINATION IN MEXICAN STYLE SOFT CHEESE IN CALIFORNIA LED TO 47 FATALITIES, INCLUDING INFANT DEATHS AND STILLBIRTHS. FURTHER, WE NOW KNOW OR SUSPECT THAT SOME FOOD PATHOGENS MAY CAUSE OR TRIGGER CERTAIN CHRONIC RHEUMATOID DISORDERS, SUCH AS ARTHRITIS AND REITER'S SYNDROME. WE BELIEVE THE TOLL IN HUMAN SUFFERING FROM FOODBORNE ILLNESS MAY BE FAR GREATER THAN ANY OF US MIGHT INITIALLY SUSPECT.

ANALYTICAL METHODS

IN THE FACE OF EMERGENCIES INVOLVING FOODBORNE ILLNESS, FDA ACTED IMMEDIATELY IN RESOLVING PREVIOUSLY UNIDENTIFIED PROBLEMS AND TAKING ACTION TO REDUCE THE RISK TO THE PUBLIC HEALTH. IN PART WE WERE AIDED BY THE BIOTECHNOLOGY REVOLUTION WHICH HAS PROVIDED FDA WITH NEW TOOLS FOR ANALYSIS. USING GENE PROBES OR MONOCLONAL ANTIBODIES WE NOW HAVE THE MEANS TO CREATE MORE RAPID AND PRECISE METHODS FOR DETECTING AND IDENTIFYING MICROBIAL CONTAMINATION OF FOOD. IN THE CASE OF LISTERIA, FDA SHORTENED THE TIME FOR DETECTING THE PATHOGEN FROM EIGHT WEEKS TO LESS THAN TWO, AND WE ARE WORKING TO DECREASE ANALYSIS TIME EVEN MORE. WE ARE CONTINUING RESEARCH ON GENE PROBES AND ON THE MINIATURIZATION AND COMPUTERIZATION OF CONVENTIONAL MICROBIOLOGICAL METHODS FOR QUICKER AND MORE QUANTITATIVE ANALYSES OF PATHOGENS. BECAUSE OF THE PREVALENCE OF LISTERIA IN DAIRY PRODUCTS, WE HAVE ENTERED INTO AN INTERAGENCY AGREEMENT WITH THE CENTERS FOR DISEASE CONTROL TO IMPROVE OUR UNDERSTANDING OF THE EXTENT OF FOODBORNE LISTERIOSIS AND THE PREDISPOSING RISK FACTORS ASSOCIATED WITH THIS DISEASE.

SULFITES AND OTHER FOOD ADDITIVES

ANOTHER FOOD SAFETY PROBLEM WE ARE ADDRESSING INVOLVES THE USE OF FOOD ADDITIVES. ON THE USE OF SULFITING AGENTS IN FOODS, WE HAVE RECENTLY MADE EFFECTIVE TWO REGULATIONS THAT WILL FURTHER PROTECT

INDIVIDUALS SENSITIVE TO SULFITES FROM SERIOUS ADVERSE RESPONSES. ONE REGULATION PROHIBITS SULFITE USE ON RAW FRUITS AND VEGETABLES EXCEPT POTATOES. A SECOND STATES THAT ANY DETECTABLE AMOUNT OF SULFITE IN THE FINISHED FOOD MUST BE DECLARED ON THE LABEL. A DETECTABLE AMOUNT OF SULFITE IS DEFINED AS TEN PARTS PER MILLION. WE HAVE IN ADDITION ISSUED A THIRD REGULATION REQUIRING WARNING STATEMENTS IN THE PROFESSIONAL LABELING OF PRESCRIPTION DRUGS CONTAINING SULFITES. CURRENTLY WE ARE CONTINUING TO REVIEW THE USE OF SULFITES ON "FRESH" POTATOES THAT REACH THE CONSUMER UNPACKAGED OR UNLABELED.

THE PROBLEM OF INDIVIDUALS WHO ARE SENSITIVE TO SULFITES PROMPTED US TO ESTABLISH A POSTMARKETING SURVEILLANCE INITIATIVE FOR OTHER FOOD ADDITIVES, AS WELL. WE NOW HAVE AN ADVERSE REACTION MONITORING SYSTEM THAT COLLECTS AND ANALYZES REPORTED ADVERSE HEALTH EFFECTS ASSOCIATED WITH FOOD, FOOD AND COLOR ADDITIVES, AND VITAMIN AND MINERAL SUPPLEMENTS. THESE REPORTS ARE SCREENED FOR SEVERITY OF REACTION TO DETERMINE WHEN FURTHER FIELD INVESTIGATION IS MERITED.

WE ARE ALSO EXAMINING WAYS TO EXPEDITE THE REVIEW OF FOOD ADDITIVE PETITIONS. IN THIS EFFORT WE PLAN TO DEVELOP A NEW POLICY FOR DETERMINING WHEN AN INDIRECT ADDITIVE (SUCH AS A PACKAGING MATERIAL) DOES NOT POSE A HEALTH RISK BECAUSE THE AMOUNT OF THE SUBSTANCE THAT MAY ENTER THE FOOD IS SO SMALL AS TO BE INSIGNIFICANT. WITH SUCH A POLICY IN EFFECT WE WILL BE ABLE TO FOCUS OUR RESOURCES ON PROTECTING PEOPLE FROM SUBSTANCES THAT MAY PRESENT A HEALTH RISK. WE BELIEVE THE RESULT OF SUCH A POLICY WILL BE FASTER REVIEW OF INDUSTRY PETITIONS. IN ADDITION, WE WILL BE AUTOMATING ASPECTS OF THE REVIEW, INCLUDING ACCEPTING DATA IN MACHINE-READABLE FORMS AND CLARIFYING THE REQUIREMENTS OF THE PROCESS.

RISK ASSESSMENT

IN ALL OF ITS ACTIVITIES FDA'S MISSION TO PROTECT PUBLIC HEALTH INVOLVES ASSESSING RISKS WHICH IMPOSE EITHER A POTENTIAL OR A CLEAR THREAT TO THE CONSUMER'S HEALTH. AS THE COMMITTEE WELL KNOWS, FDA IS PRESSED TO MAKE REGULATORY DECISIONS, SUCH AS THOSE ON LEVELS OF DIFFERENT SUBSTANCES IN THE FOOD SUPPLY, IN THE FACE OF INCREASINGLY SENSITIVE MEASURING TECHNOLOGY WHILE WE MUST ADHERE TO STRICT LEGISLATIVE STANDARDS SUCH AS THE DELANEY CLAUSES IN THE FOOD, DRUG, AND COSMETIC ACT. BY APPLYING THE SCIENTIFIC CONCEPT OF RISK ASSESSMENT, FDA HAS REFRAINED FROM TAKING ACTION IN SITUATIONS WHERE MINUTE QUANTITIES OF A CARCINOGENIC SUBSTANCE PRESENTS ESSENTIALLY NO HUMAN RISK. HOWEVER, THE RISK ASSESSMENT PROCESS WITHIN FDA MUST BE CONSIDERED NOT ONLY AS AN FDA CONCERN, BUT ALSO A CONCERN OF OTHER AGENCIES WHO USE RISK ASSESSMENT PROCESSES AND PROCEDURES. MANY OF THE TOXIC CHEMICALS REGULATED BY FDA ARE REVIEWED BY THE ENVIRONMENTAL PROTECTION AGENCY, THE CONSUMER PRODUCT SAFETY COMMISSION, AND THE OCCUPATIONAL SAFETY AND HEALTH ADMINISTRATION, AND OTHERS. FDA SEEKS TO DEVELOP A STANDARDIZED AND UNDERSTANDABLE METHODOLOGY THAT WILL PROVIDE UNIFORMITY OF SOME OF THE PROCESSES AND PROCEDURES USED IN RISK ASSESSMENT ACROSS GOVERNMENT.

MANY CONSUMERS ARE CONFUSED BY CONFLICTING STATEMENTS OF HUMAN RISK, AND DO NOT UNDERSTAND THE RELATIVELY LARGE RANGE OF UNCERTAINTY SURROUNDING THE BEST ESTIMATES OF RISK. AND WITH HUNDREDS OF CHEMICAL COMPOUNDS THAT ARE SUSPECTED TO CAUSE CANCER IN ANIMALS, CONSUMER CONFIDENCE WILL ERODE FURTHER UNLESS WE CAN RESOLVE THE UNCERTAINTIES CURRENTLY SURROUNDING RISK ASSESSMENT AND EDUCATE THE PUBLIC ON THE ISSUES. SOME OF THESE COMPOUNDS, SUCH AS NITRITES, OCCUR NATURALLY AND ARE A PART OF OUR DIET. OTHERS ARE INTRODUCED INTO OUR ENVIRONMENT BUT AT SUCH MINUTE QUANTITIES THAT THEY PRESENT ESSENTIALLY NO RISK. WE NEED BETTER SCIENTIFIC METHODOLOGIES TO REGULATE THE COMPOUNDS.

THE UNCERTAINTY ASSOCIATED WITH OUR CURRENT METHODS REQUIRES THAT OUR SCIENTIFIC JUDGMENT BE BASED ON EXTREMELY CONSERVATIVE ASSUMPTIONS. AS OUR SCIENTIFIC KNOWLEDGE INCREASES AND WE ELIMINATE THESE UNCERTAINTIES, OUR POLICIES ON LEVELS OF SUCH THINGS AS UNINTENTIONAL OR INADVERTENT CONTAMINANTS CAN BE MORE CLEARLY ESTABLISHED UPON SOUND SCIENTIFIC PRINCIPLES.

A KEY TO OUR PROGRESS IN APPLYING RISK ASSESSMENT IS OUR STRONG SCIENTIFIC AND RESEARCH CAPABILITY, BOTH AT OUR CENTER FOR FOOD SAFETY AND APPLIED NUTRITION AND AT OUR NATIONAL CENTER FOR TOXICOLOGICAL RESEARCH IN ARKANSAS. HAVING ACHIEVED SUCCESS IN DEVELOPING ANALYTICAL METHODS CAPABLE OF DETECTING MINISCULE LEVELS OF CONTAMINANTS, WE ARE NOW REDIRECTING OUR SCIENTIFIC RESOURCES TOWARD DEVELOPING IMPROVED, IMPACT-ORIENTED METHODS FOR ASSESSING THE RISKS THAT MAY BE POSED BY PRODUCTS FOUND IN THE FOOD SUPPLY. WE MUST LOOK FOR THE SIGNIFICANCE OF CHEMICALS WITHIN THE FOOD SUPPLY; WE SIMPLY CANNOT CONTENT OURSELVES WITH A CHASE TOWARDS ZERO. TO ACCELERATE THESE EFFORTS, WE ARE REQUESTING AN INCREASE OF $1 MILLION FOR THE NATIONAL CENTER FOR TOXICOLOGICAL RESEARCH.

ANOTHER AREA OF RISK ASSESSMENT THAT I WOULD LIKE TO MENTION IS THAT OF MEDICAL DEVICES. HERE THE APPROACH MUST BE INDIVIDUALIZED ACCORDING TO THE NATURE OF THE DEVICE. PROBLEMS IN THE MANUFACTURING PROCESS, FAULTY PRODUCT DESIGN, MATERIALS DEGRADATION AND USER ERRORS ARE EXAMPLES OF THE MANY VARIABLES WHICH AFFECT THE RISK ASSOCIATED WITH THE USE OF A DEVICE. THE HIGHLY PUBLICIZED SHILEY HEART VALVE THAT WAS VOLUNTARILY WITHDRAWN FROM THE MARKET IS A GOOD EXAMPLE OF THE IMPORTANCE OF THIS EFFORT. BY MEANS OF A STRONGER SCIENCE BASE AND EDUCATION EFFORTS, WE HOPE TO REDUCE THE CONFUSION SURROUNDING THE ISSUE OF RISK ASSESSMENT.

RISK MANAGEMENT

AS A PART OF THE RISK MANAGEMENT INITIATIVE UNDER THE ACTION PLAN, FDA RESPONDED TO A NUMBER OF CHALLENGES, A FEW OF WHICH I WOULD LIKE TO HIGHLIGHT FOR YOU BRIEFLY.

EMERGENCIES

DURING 1986 FDA RESPONDED TO A UNPRECEDENTED NUMBER OF EMERGENCIES. FDA RESPONDED TO MORE THAN 1,500 REPORTS OF PRODUCT TAMPERING, AND TESTED MORE THAN ONE MILLION TYLENOL CAPSULES FOR CYANIDE. ALERTED BY LISTERIOSIS OUTBREAK FROM CONTAMINATED JALISCO SOFT CHEESE, FDA BEGAN TESTING FRENCH SOFT CHEESE AND FOUND SAMPLES WHICH HAD LISTERIA CONTAMINATION OF 1,000 TO 1,000,000 PER GRAM. THE JALISCO CHEESE WHICH HAD PROVED FATAL FOR SOME TESTED AT ONLY 1,000 TO 100,000 LISTERIA PER GRAM. BY THE END OF 1986, FDA HAD INSPECTED 250 DOMESTIC DAIRY PROCESSING PLANTS AND ANALYZED OVER 3000 SAMPLES, RESULTING IN 20 RECALLS BY FIRMS AND DISTRIBUTORS - ACTIONS THAT SURELY PREVENTED ADDITIONAL SEVERE ILLNESS OR DEATHS.

DURING THE GERBER BABY FOOD CRISIS, FDA EXAMINED MORE THAN 60,000 JARS OF BABY FOOD FOR GLASS FRAGMENTS. IN THE WAKE OF PUBLICIZED REPORTS OF GLASS IN GERBER BABY FOOD, THE AGENCY'S KNOWLEDGE OF THE INDUSTRY, COUPLED WITH MUCH PAINSTAKING WORK, NOT ONLY ASSURED THE SAFETY OF THE PRODUCT BUT ALSO EXONERATED THE COMPANY AND POSSIBLY SAVED IT FROM FINANCIAL RUIN. IN RESPONSE TO THE HEPTACHLOR CONTAMINATION OF DAIRY FEED, FDA COLLECTED AND TESTED MORE THAN 1,350 MILK AND MILK PRODUCT SAMPLES, RESULTING IN THE QUARANTINE OF 56 FARMS IN 3 STATES. AND AS A RESULT OF THE CHERNOBYL INCIDENT, FDA SO FAR HAS TESTED 840 IMPORT SAMPLES FOR RADIOACTIVE ISOTOPE CONTAMINATION. THE 1986 COSTS IN HANDLING THESE EMERGENCIES AND OTHER UNPLANNED WORK AMOUNTED TO OVER 500 PERSON YEARS AND ABOUT $23 MILLION, DERIVED LARGELY BY DIVERTING

OUR STAFF FROM NORMAL FIELD SURVEILLANCE, INVESTIGATIONAL, AND ANALYTICAL ACTIVITIES. IN TERMS OF OUR DIRECT COST FOR OVERTIME, EXTRA TRAVEL AND SUPPLIES, WE WERE ABLE TO USE OUR CONTINGENCY FUND WHICH WAS INITIALLY APPROPRIATED IN 1983. I AM PLEASED THAT AS WE HAVE COPED WITH ALL THESE EMERGENCIES, WE HAVE RECEIVED APPRECIATION NOT ONLY FROM CONSUMERS BUT ALSO FROM SOME OF THE FIRMS AFFECTED, AND I WOULD BE PLEASED TO SUBMIT FOR THE RECORD SOME LETTERS WE HAVE RECEIVED FROM THESE FIRMS.

OVER THE PAST TWO YEARS THE AGENCY HAS BEEN ABLE TO RESPOND EFFECTIVELY TO A NUMBER OF SERIOUS HEALTH CRISES INVOLVING PATHOGENIC BACTERIA AND OTHER CONTAMINANTS. THIS IS IN LARGE MEASURE DUE TO THE EMPHASIS ON POTENTIAL HAZARDS AND THE INHERENT FLEXIBILITY WHICH FDA HAS BUILT INTO ITS SURVEILLANCE STRATEGY. HOWEVER, THIS HAS AFFECTED OUR NORMAL INSPECTIONS TO A POINT WHERE WE NEED TO RESTORE OUR ABILITY TO PREVENT THE RECURRENCE OF SIMILAR EMERGENCIES. FOR THIS REASON WE ARE REQUESTING AN INCREASE OF $1.0 MILLION AND 20 STAFFYEARS TO STRENGTHEN OUR FOOD SURVEILLANCE ACTIVITIES.

ENFORCEMENT STRATEGIES

IN MANAGING RISKS TO THE HEALTH OF THE AMERICAN PUBLIC, FDA USES BOTH EDUCATIONAL AND REGULATORY APPROACHES. WHEN PROBLEMS OCCUR THAT CAN BE ATTRIBUTED TO USERS OF PRODUCTS, WE USE AN EDUCATIONAL OR TECHNICAL ASSISTANCE APPROACH AS MOST APPROPRIATE. ONE EXAMPLE OF WHERE THIS APPROACH IS BEST CONCERNS THE USE OF ANESTHESIA GAS DELIVERY DEVICES. EACH YEAR 2,000 TO 10,000 PATIENTS DIE DURING SURGERY, AND FDA LEARNED THAT A NUMBER OF DEATHS WERE ASSOCIATED WITH THE USE OF CERTAIN ANESTHESIA DEVICES. IN MANY OF THESE INCIDENTS, THE OPERATORS WERE NOT USING THE ANESTHESIA MACHINES IN THE PROPER MANNER. WE RESPONDED BY DEVELOPING A CHECKOUT PROCEDURE FOR THE ANESTHESIA MACHINES IN COOPERATION WITH ANESTHESIOLOGY PROFESSIONALS AND THE MANUFACTURERS. THIS

PROCEDURE CAN BE USED DAILY, AND BY DETECTING COMMON ERRORS AND EQUIPMENT DEFECTS, WE CAN HELP REDUCE INJURIES AND SAVE LIVES.

IN CASES WHERE THERE IS A PROBLEM ASSOCIATED WITH THE DESIGN, MANUFACTURING, DISTRIBUTION, OR LABELING OF A PRODUCT, FDA USES A REGULATORY APPROACH. SOMETIMES THIS INVOLVES RELYING ON VOLUNTARY ACTION BY INDUSTRY, SUCH AS A FIRM INITIATED RECALL. WHEN A PROBLEM HAS BECOME TOO SERIOUS TO BE HANDLED BY A REGULATORY LETTER, FDA CAN SEEK AN INJUNCTION OR INITIATE SEIZURE OF A PRODUCT. TO REMOVE LISTERIA CONTAMINATED SOFT CHEESE FOR THE MARKETPLACE, FDA USED BOTH RECALLS AND SEIZURES. IN THE CASE OF IMPORTS, FDA CAN DETAIN A SHIPMENT UNTIL IT IS BROUGHT INTO COMPLIANCE, DESTROYED OR RE-EXPORTED. WITH PERISHABLE FOOD IMPORTS, FDA MUST ACT QUICKLY TO ANALYZE SAMPLES FOR POSSIBLE CHEMICAL OR MICROBIAL CONTAMINATION. WE ARE TAKING A NUMBER OF STEPS TO STREAMLINE OUR PROCESSING OF THE VARIOUS KINDS OF ACTION, TO ASSURE THAT WHEN NEEDED THE APPROPRIATE ACTION IS TAKEN AS EXPEDITIOUSLY AS POSSIBLE.

IMPORTS

FDA HAS FOR SOME YEARS RECOGNIZED THE NEED TO STRENGTHEN ITS SURVEILLANCE OF IMPORTED FOOD , AND UNDER THE ACTION PLAN HAS ACCOMPLISHED MUCH TOWARD THIS END. SINCE 1971, THE NUMBER OF PRODUCTS UNDER FDA SURVEILLANCE HAS ALMOST TRIPLED, AND A LARGER PROPORTION OF THESE ARE READY-TO-EAT FOODS, WHICH AFTER LEAVING CUSTOMS REACH THE CONSUMER WITHOUT ANY FURTHER INSPECTION BY FDA. IMPORTS OF BULK RAW GOODS, ON THE OTHER HAND, CAN BE FURTHER EXAMINED AT U.S MANUFACTURING PLANTS. IN ADDITION, THIRD WORLD EXPORTER COUNTRIES DO NOT HAVE ESTABLISHED QUALITY STANDARDS FOR THEIR PRODUCTS, AND AS A RESULT, FDA OFTEN PROVIDES THE ONLY QUALITY CONTROL POINT FOR THESE PRODUCTS. RECOGNIZING THE CRITICAL NATURE OF THIS PROBLEM, FDA INCREASED STAFFYEARS DEVOTED TO IMPORTS BY 24% SINCE 1984, AND THE RESULT HAS BEEN DRAMATIC, WITH A INCREASE OF 38% IN THE NUMBER OF DETENTIONS. FDA IS ALSO REVISING IMPORT ENFORCEMENT APPROACHES IN AN EFFORT TO INCREASE ACTION AGAINST PROBLEM IMPORTERS AND BROKERS. FDA WILL INCREASE EFFORTS TO IMPROVE COOPERATION WITH FOREIGN GOVERNMENTS, AS WELL. OTHER INITIATIVES ARE DISCUSSED FURTHER IN THE REPORT WE RECENTLY PROVIDED TO THE COMMITTEE.

IMPACT OF NEW TECHNOLOGIES

BY THE VERY NATURE OF OUR WORK AT FDA, WE FUNCTION AS THE GATEKEEPER OF TECHNOLOGY TRANSFER FROM THE LABORATORY TO THE MARKETPLACE. FOOD INDUSTRIES ARE EXPERIENCING A TECHNOLOGICAL EXPLOSION, PARTICULARLY IN THE AREA OF FOOD PROCESSING. BIOTECHNOLOGY IS REVOLUTIONIZING THE DETECTION AND CURE OF DISEASE. MICROELECTRONICS HAS CREATED A PROLIFERATION OF COMPUTER-CHIP AND MICROELECTRONIC COMPONENTS IN MEDICAL DEVICES. FDA SEEKS NOT TO INHIBIT THIS TRANSFER OF TECHNOLOGY BUT TO PROMOTE IT, BUT WITHOUT ENDANGERING THE PUBLIC HEALTH AND THE ENVIRONMENT. IN ORDER TO DO SO, WE WILL CONTINUE TO STRESS DEVELOPING AN EXCELLENT SCIENCE BASE AND APPLIED RESEARCH PROGRAM SO THAT WE CAN ENCOURAGE THAT TRANSFER AND IN DOING SO PERFORM OUR MISSION TO PROMOTE THE PUBLIC HEALTH. IN THIS REGARD, EROSION OF FDA'S SCIENTIFIC EXPERTISE WOULD SERVE THE PUBLIC POORLY.

BUDGET REQUEST SUMMARY

NOW LET ME ADDRESS OUR 1988 REQUEST SPECIFICALLY. OUR TOTAL REQUEST FOR 1988 IS FOR $483.5 MILLION, OF WHICH $33.8 MILLION WOULD BE DERIVED FROM COLLECTIONS OF PROPOSED PRODUCT REVIEW CHARGES. THE REQUEST MAINTAINS THE CURRENT LEVEL OF PROGRAM OPERATIONS BY PROVIDING FOR INCREASED PAYROLL AND OTHER OPERATING COSTS, INCLUDING THOSE FOR THE NEW FEDERAL EMPLOYEE RETIREMENT SYSTEM. ALSO INCLUDED IN THE REQUEST ARE SOME SELECTED PROGRAM INCREASES, WHICH I WILL SUMMARIZE.

FOR NEW PRODUCT REVIEW WE PROPOSE AN INCREASE OF $1.6 MILLION INCLUDING 32 STAFFYEARS TO IMPROVE NEW DRUG REVIEW, AND $0.6 MILLION INCLUDING 12 STAFFYEARS TO IMPROVE MEDICAL DEVICE REVIEW. FOR AIDS WE ARE REQUESTING AN INCREASE OF $1.0 MILLION INCLUDING 22 STAFFYEARS TO SPEED THE DEVELOPMENT OF VACCINES AND THERAPIES FOR THE DISEASE, AND TO ASSURE CONTINUED PROTECTION OF THE NATION'S BLOOD SUPPLY. TO STRENGTHEN OUR FOOD SURVEILLANCE ACTIVITIES, WE HAVE INCLUDED IN OUR REQUEST AN ADDITIONAL $1.0 MILLION TO SUPPORT 20 STAFFYEARS, AND TO INCREASE OUR RISK ASSESSMENT CAPABILITIES AT THE NATIONAL CENTER FOR TOXICOLOGICAL RESEARCH WE HAVE INCLUDED AN INCREASE OF $1.0 MILLION.

THIS YEAR'S BUDGET ALSO INCLUDES A REQUEST FOR AN ADDITIONAL $10.0 MILLION IN 1987, TO BE DERIVED BY TRANSFER, IN ORDER TO COVER INCREASED COSTS RESULTING FROM THE JANUARY 1987 PAYRAISE AND THE NEW FEDERAL EMPLOYEE RETIREMENT SYSTEM.

AS I MENTIONED EARLIER WE ARE WORKING ON A SEPARATE LEGISLATIVE PROPOSAL TO PROVIDE FDA WITH THE AUTHORITY TO CHARGE USER FEES FOR REVIEWING MANUFACTURERS' APPLICATIONS TO MARKET NEW DRUGS AND MEDICAL DEVICES. THE AGENCY'S ACTIVITIES IN THESE AREAS CLEARLY BENEFIT INDUSTRY AT THE SAME TIME THEY PROTECT CONSUMERS, AND SO WE BELIEVE THESE CHARGES ARE APPROPRIATE. WE ARE FULLY AWARE OF THE PAST CONGRESSIONAL GUIDANCE ON USER CHARGES, AND THAT IS WHY WE WILL BE SUBMITTING A SEPARATE LEGISLATIVE PROPOSAL TO ALLOW FOR FULL CONGRESSIONAL REVIEW OF THE ISSUE.

MR. CHAIRMAN, THIS CONCLUDES MY PREPARED REMARKS. I WOULD BE HAPPY TO RESPOND TO ANY QUESTIONS YOU OR THE OTHER MEMBERS MAY HAVE.

COMMON COLD

Senator **Burdick**. Before I ask you some questions, Dr. Young, general questions—I have a specific question.

Dr. **Young**. Yes, sir.

Senator **Burdick**. I have been fighting a cold for 3 weeks, and I haven't seen anybody nor do I know any doctor who can do something about it. We are talking about exotic diseases and so forth, what about the common cold?

Dr. **Young**. I think, sir, the common cold is probably one of the more difficult things to eradicate. There are over 100 viruses that can cause the cold and you have an occupational hazard. You are requested to meet individuals from all over the nation with many different respiratory diseases, and you have a work style that provides you with little sleep.

Good bed rest is one of the best things, I am sure that you might not be able to get an abundance of rest in your position of leadership.

Senator **Burdick**. Well, I suppose it goes with the territory.

Dr. **Young**. I think so, sir, regretfully.

BUDGET PROPOSAL

Senator **Burdick**. The fiscal year 1988 budget proposes program expenses and salary increases of over $25 million to improve research, review and protect efforts in a number of key areas.

In initiating the second phase of the FDA's Action Plan, have you delineated what the highest priority program is, giving consideration to both Federal budgetary constraints and public health protection? What is the highest program priority for FDA in the coming fiscal year?

Dr. **Young**. Yes, sir; we have examined that very carefully. We have, throughout the Action Plan, reprogrammed within the limits of the guidance of Congress a number of resources to meet these needs.

Our highest priority is the battle on AIDS. We feel that this is going to be one of the gravest infectious diseases ever to confront mankind and, accordingly, we have proposed within the budget a substantial increase. We are also concerned, and a bit surprised, at the rate in which discoveries related to AIDS have come forth.

FDA does not want to be a bottleneck, and thus we will reallocate, in addition to those resources, as much as possible to meet that need. We have introduced a 1–AA priority, which means that the Agency pledges to act on, approve or disapprove, new therapies for AIDS within 180 days. That stands in contrast to over 25 months on the average for our drug review process.

Concomitant with that is the Agency's high priority for product approval, and those are the two highest priorities, but they really are interrelated within the Agency.

SLUC

Senator **Burdick**. In addition to the legislative proposal to impose new user charges, FDA's budget includes the line item of standard level user charges. The estimated level of user charges for fiscal year 1988 is

$34.5 million, almost $9.9 million above the 1987 estimated level of $24.6 million.

To what is this sharp increase in standard level user charges attributed?

Dr. YOUNG. The concept of user charge is an important one. It is one that comes forward recognizing that in principle, individuals and corporations who benefit from activities could be considered and should be considered for user fees.

The obvious thing that must be done is the passage of legislation before such user fees can be collected, and that is something that the Agency is focusing on. The increase this year relates to the proposal to include user fees for devices, as well as drugs.

The other charges that you may be referring to is the rent that is a standard payment to GSA. That has been in the budget for a long period of time. GSA sets our rents.

Senator BURDICK. Why the increase?

Dr. YOUNG. The increase in the user fees, or the increase in the rent?

Senator BURDICK. Rent to be almost $9.9 million above the 1987 estimated level.

Dr. YOUNG. Yes; it is the fact that that is beyond our control. The GSA sets our rent, sir, and the budget merely reflects the estimates provided to us by GSA. The increase occurs because of increased charges by GSA for our current space. FDA is not increasing the space we occupy.

Senator BURDICK. In other words, see the landlord?

Dr. YOUNG. That is correct. I have been trying to deal with that for a while. It is interesting, when I had the responsibility for the medical center in my former life, we were our own landlords, and it was a little bit simpler, one might say.

IMPORTED FOODS

Senator BURDICK. Safety inspections of imported food products are of great concern to the American public, particularly with respect to pesticide use on these products. Since FDA is the principal government agency responsible for inspection of food imports, could you explain how you are managing to assure the American consumer that these products are carefully screened before they are admitted into the United States?

Dr. YOUNG. This is, as I said, sir, one of the most vexing issues facing the Agency. We have only more recently realized that there are significant health problems associated with imports. We have adjusted to this by reallocating our planned field resources, and have put 46 percent more resources to imports.

I think the real message is that not only have we put resources in, but it is working.

In the graph, you can see we have focused, in yellow, on wharf examinations. You will note that they have increased by 28 percent. That is very important because we go right to the wharf and examine what is coming in.

The next thing that we do is look at samples. That is more labor-intense than it is in our domestic processes because, unlike going to the factory and inspecting it, we have to analyze it. The two examples that I gave you earlier dealt with colors and chemicals, and we have had the same thing as we have looked at pesticides.

As one example, we worked earlier with the German government because there were some pesticides in hops coming into the United States. So we look at those products and then we detain them if necessary, and you can see our detention rates have gone up, as well. So we are focusing on that.

MICROBIAL CONTAMINATION

There is something that I believe that this committee needs to know, and the American people need to know, and that is that microbial contamination of food is even more significant than pesticides. We've come to that conclusion based on two pieces of data.

First, we have a total diet program, an interesting program in which food is gathered from many U.S. locations, prepared, and then analyzed for both pesticides and chemicals. We have not found a significant increase in the pesticides in the diet that you and I would be eating.

On the other hand, when we look at the microbial infection, we have had real problems. Let me give you one example that would suffice. We did find in the state of California, following very careful work done by a nurse epidemiologist, that some cheese produced by a company, Jalisco, was contaminated with a microbe called Listeria monocytogenes. It resulted in over 80 cases of illness with a fatality rate approaching 50 percent.

As we carefully examined this, we took some French brie cheese as a control. To our amazement, the highest level of contamination of the brie samples was 10 times higher than the Jalisco cheese which produced a 50-percent mortality rate in the infected individuals.

We feel that putting up the border patrol and then getting a memorandum of understanding with France, we saved many lives. We had the same problem with cheese coming in from other Mediterranean bordering countries.

We feel that microbial disease that we can trace produces not only illness, but in some instances death; we do not have quite the same problem of a definite showing of degrees of illness with pesticides, and our total diet study continues to indicate generally safe levels of pesticides. But clearly, we are going to focus on imports.

In Action Plan, Phase II, you will see a whole program on this issue, and we feel this is a problem. We are delighted to work with you. And I would be happy to brief you, sir, in any way that I can on this. We want to balance our resources between both pesticides and microbial infection.

Senator BURDICK. Mr. Cochran.

Senator COCHRAN. Thank you, Mr. Chairman.

Mr. Chairman, I would first like to request the opportunity to submit some questions to the witnesses who testified concerning the budget request of the Commodities Futures Trading Commission. I will submit those in writing to the witnesses, with your permission.

Senator BURDICK. Without objection, so authorized, and all members of the committee are welcome to do the same.

Senator COCHRAN. I want to join you, Mr. Chairman, in welcoming this panel of witnesses, and specifically, Dr. Young, to our hearing this morning. We appreciate the assistance that you are providing to us in helping to understand the priorities in the budget request, and how we can assist by making sure that adequate funding levels are made available to do the work that is required by law of the Food and Drug Administration.

This Agency is unlike some other agencies in that what it does is mandated and required by statute. I notice one provision of the law even provides for a statutory time period within which certain actions have to be taken, decisions made, approvals or disapprovals issued.

Dr. YOUNG. Yes, sir.

BUDGET REQUEST

Senator COCHRAN. In that connection, is it your judgment that this budget request will provide the FDA with the people and resources necessary to discharge the responsibilities that it has under the law?

Dr. YOUNG. You know, Senator Cochran, of our long-term commitment to try to come within statutory response on the drug approval. Instead of meeting our target of 180 days, the average approval takes about 25 months—with one exception, and that was the newly developed 1–AA priority for AIDS.

In that case, I am pleased to inform you that under the leadership of Dr. Parkman, the acting director of the Center for Drugs and Biologics, and Dr. Bilstad, Dr. Tabor and Dr. Cooper, we have been able, for many products, to meet the 180-day statutory timeframe.

We handle AIDS applications in a unique way. There we formed teams early, had them well prepared in advance; and that formation of teams enabled the applications not to stand in line before review.

We still have many things to be done to try to bring the rest of the review process into that 180 days, which we would like to shoot for. We were able to do this in relation to the drug price competition and Patent Term Restoration Act of 1986, and we now have 95 percent of ANDA's reviewed in less than 140 days.

But it is difficult to marshall all the resources that are required to meet all parts of this. We tried to be prudent. We tried to suggest things like user fees to finance additional personnel so that we could drop the average review time. It is fair to say that we are struggling very hard to meet that, and we will try to change our priorities and meet any guidance that you can give us, for we know that the approval process is very important.

The companies' investment of about $100 million is held hostage, while many times we must wait 13 months to get to their applications. We can't allow that to happen on drugs for AIDS. Where I am most desperately concerned is that we are now getting candidate vaccine applications, as you saw in the Washington Post—we did not think they would be coming this fast.

If we don't have appropriate resources, our ammunition factory won't work properly for the American people.

AIDS RESEARCH

Senator COCHRAN. In the specific case of AIDS, I understand the committee in the House has reported a supplemental which contains an additional $1.5 million to provide 22 additional full-time staff-years and equipment for AIDS research.

If additional funding, such as that provided by the House is made available, how would you use these additional resources?

Dr. YOUNG. We would do the following, sir. We have right now an excellent team dealing with virus work that looks at agents such as AZT, known as Retrovir. We would like to form more teams.

We feel that that sort of a formation of teams would enable us to meet with the company sponsor before the IND is filed, to work with them throughout the investigational phase, as well as the new drug application phase, and with those kinds of resources we would continue our pledge not only to try to deal with the drugs and absolutely approve or disapprove the drugs in 180 days, but we want to do the same thing in vaccines.

The future is going to be in vaccine work for prevention, we feel, and we would like to form such teams there.

CONTRACTING OUT

Senator COCHRAN. The other day, I received an expression of some interest from the University of Mississippi in doing some studies and research in another area. It was described to me as a study of biologically active substances from plants. This doesn't have anything to do with AIDS, this is another issue area completely.

Is your Agency involved in any way in contracting out or in reviewing studies about the efficacy of traditional medicines or herbal teas which have biologically active substances?

Dr. YOUNG. No; we have not done that directly. But let me raise two points that might be of help. First, many of the medicines that came to be very important were from plants—Foxglove gave us digitalis, quinine from the bark of a tree—this is a very important area, and actually marine animals and marine plants are being examined for inhibitory substances. So it is a fruitful area, but we have not supported any research grants.

However, we do have a very interesting pilot. We have used our National Center for Toxicological Research to work with the southern universities. We have a very active program of collaboration, not only for graduate students there, but also for faculty working on risk assessment.

That is another dominant area in the Action Plan because risk assessment enables us to review the issues on de minimis, such as with color additives, and Dr. Hart, who is director of the National Center for Toxicological Research, has been very active in working with the southern universities.

We feel that collaborative research on new and exciting leads, as well as the regulatory programs of FDA, have been an extremely important portion of our mission.

That shoots a little bit to the side of your question, but we don't have anything directly on plants to the best of my knowledge.

LABORATORY CLOSINGS

Senator COCHRAN. Last year there were several Senators who expressed some concern to me about the plans of FDA to close some of its district laboratories. GAO had done a study and had stirred up a lot of interest—I don't know which came first, the study or the interest.

Could you update us on the plans, if any, to close some of the FDA district laboratories?

Dr. YOUNG. I can surely do so. Let me bottom line it first, and then give you the explanation. We will not do anything until we have the complete analysis and approval of Congress.

The reason we embarked on this was that about 20 to 30 percent of our laboratory benches are vacant. We just have not had the resources to utilize the laboratories fully, and based on that, we felt that it was wise managerially to close down some of the laboratories, to avoid costs associated with maintaining more underutilized facilities, and to be able to get the state-of-the-art equipment for others.

Since that time also, an additional feature has come to our knowledge, and that is the crisis that we are focusing on with imported foods where we have to test many samples. We have to do much more laboratory work, so that though we embarked on that as an appropriate managerial concern, we are now faced on the other hand with a need. We are wrestling to see whether or not we can reallocate funds to expand some of our laboratory functions.

But I must say as a manager, if we really have 25 percent of our space vacant, and as the chairman said, with the landlord always trying to raise the rent, one of the ways to deal with that is to close some of the labs. But that is not a popular decision, and it may not always be the wise one, particularly if we need to focus long-term on the possibility of more laboratory resources for imports.

Senator COCHRAN. Are any of the funds requested for rental payments in the budget going to these vacant labs or for labs that are not being used?

Dr. YOUNG. Yes, they are, sir. None of the labs are vacant, however—they just contain some underused labs. That is the problem. I can get that from our budget people, and give you the exact figures for the record.

[The information follows:]

RENTAL COSTS OF UNDERUTILIZED LABS

Although 25 percent of FDA's field laboratory space was vacant in December 1986, that is not equivalent to the amount of laboratory space that we consider unnecessary excess. Changing program needs may demand expanding our laboratory staff, and it is therefore reasonable to keep some reserve on hand since it usually takes years to build additional space suitable for laboratory work. In fact, due to recent recurring problems with imported foods, FDA has in its budget request for fiscal year 1988 a $1 million increase for additional 20 FTE's, some of which will be used to expand our laboratory staff.

A problem in reducing our excess laboratory space is that the space is interspersed in a number of different laboratories, and it is not possible to give up the space without moving the entire laboratory to a new space or a new building. Our approach to this problem was to identify those laboratories which were most appropriate to close and to transfer the laboratory staff and functions to other locations where there was sufficient space to accommodate them.

The laboratory consolidation plan was based on closing the laboratories in Buffalo, Kansas City, Cincinnati, Minneapolis, and San Francisco. If FDA had executed the plan as previously envisioned, the agency would have reduced the vacant laboratory space by 40 percent and saved an estimated $1,318,000 in rental costs in fiscal year 1988. In terms of FDA's overall needs for field laboratory space, this amount represents the expense FDA pays for the excess space.

However, potential future savings at this point depend on GAO's completion of their report and FDA's subsequent reevaluation of the need to consolidate some field labs.

Senator COCHRAN. That would be helpful. I think we probably ought to know that.

Dr. YOUNG. We tried to make the close-down dependent on where the oldest facilities were and where some of the problems were in remodeling them. It was an attempt to really try to manage well, and now we are faced with the best way we can on tradeoff our resources. It has been a tough problem.

BULK ANIMAL DRUGS

Senator COCHRAN. I have heard from some of my veterinarian friends that they have some difficulties with the FDA in getting approval to purchase and use drugs in bulk in their veterinary practice.

Is this a legal constraint or a regulatory decision FDA has made? Could you tell me what the problem is with that?

Dr. YOUNG. Surely, sir. That is a legal constraint. One of the problems facing us is that some of the companies engaged in bulk drugs import the bulk drugs from overseas without having approved new animal drug applications to do so.

Some of the drugs are drugs that are not used widely in the United States, while others are common drugs, but the specific point is that a company doesn't have approval to sell such drugs in bulk to veterinarians who would then further process the drug.

If the drug is a legal drug, manufactured by a legal firm, that is one issue. However, in many cases we have found they are really importing drugs from overseas and we are concerned about the quality control and about the possibility of harm to animals, and more importantly tissue residues left from unapproved drugs that could be harmful to human beings.

So that it is a problem. We are trying to stay within the law, and regretfully, I know it has caused a bit of concern from some of the veterinarians.

FOODBORNE ILLNESS

Senator COCHRAN. I knew you mentioned the work you were doing in regard to the increased level of inspection and monitoring of imported foodstuffs. The foodborne illness problem, not just from imported foodstuffs, but also Salmonella and other problems that we have had in the past is one that is alarming, and disturbs the people of this country.

You mentioned in your statement that a major focus on phase II of the FDA's Action Plan is food safety. Could you elaborate on your plans for the development of a program that would involve foodborne illnesses and contamination of foods?

Dr. YOUNG. Yes, sir; we are going to first focus on that plan on problem identification. We have found with looking at some of the problems of Listeria in cheese, that our methods are outdated. We now know with the development of recombinant DNA technology that we can get gene probes that will identify organisms in hours rather than weeks.

We intend to update our methods. We also intend to, in problem identification, determine the areas of research that are required to show where pathogenic organisms might be a problem. Listeria will be targeted.

There are many others, and we will provide for you for the record the Action Plan at the earliest date. We are also going to look at problem prevention. We want to focus on approval of products. The sweeteners, some of the issues of hypersensitivity, on sulfites, et cetera.

We are also going to be looking at problem resolution and focusing on our enforcement programs, our compliance programs to determine ways that we can assure to the highest degree possible that our food supply which is safe even gets safer. We feel that food technology and food safety are very, very important issues.

We will also apply the de minimis approach that we have been dealing with, so that if there is a hazard, we will remove it; if there is not a hazard, as in the level that we have been suggesting, of an additional possibility in my lifetime or your lifetime, of one in a million, of an additional cancer beyond what we are dealing with, that that is just an insignificant risk.

So we will reexamine those issues. We will also focus on our science base. If we are not a good scientific agency, then in the long run, we will fail the American people. Those will be the broad outlines, and I will be happy to provide the chapter as soon as it finishes administrative review.

[CLERK'S NOTE.—The chapter is available in the subcommittee files.]

Senator COCHRAN. Thank you, Dr. Young.

Dr. YOUNG. Thank you.

Senator COCHRAN. Thank you, Mr. Chairman.

SULFITES

Senator BURDICK. In July 1986, when FDA issued its final ruling stating that the use of sulfites on fresh fruits and vegetables is not "generally recognized as safe," it noted that warning labels on sulfite-treated foods were an ineffective protection for the public.

At that time, FDA also noted that it "intended to address the 'generally recognized as safe' status of all other uses of sulfiting agents, including their use on potatoes and potato products, in the near future."

To date, the FDA has failed to issue final regulations on the use of sulfites in other products. Why has FDA failed to publish rules that were required by law on June 30, 1986?

Dr. YOUNG. Sir, this has been a very complicated issue. The rule that you are speaking to is in the very final phases of evaluation within the administration, and we truly hope it will be coming out soon.

As a person who is allergic, myself—not to sulfites, but to crabs—I certainly can sympathize, and have been driving this regulation at the maximal speed. I am proud of the fact that in a short time we did get a rule stating that use on fresh fruits and vegetables is not generally recognized as safe [GRAS] and we now require labeling on packaged foods and on drug products.

This project has been hard because we really didn't have the scientific basis to deal with the potato issue and therefore we had a committee on hypersensitivity that has just brought the recommendation recently, and they have recommended to FDA that sulfites in fresh potatoes were not appropriate. We have acted on this.

I would be happy to provide the preliminary report. I don't believe we have the absolute final report, but I would be happy to provide the preliminary reports for the record, and I assure you that I have been attempting to solve this problem with the greatest speed, but it has been a complicated scientific issue.

Some of the questions are, is the sulfite, when bound, not an allergen, or is it when free an allergen, and therefore, because of this concern, I originally, and I think wisely, separated the fresh fruit and vegetable issue from the potato issue, and the potato question has just taken a long time for scientific analysis.

I apologize. In my previous life, I was a bacteriologist, and the culture took 18 hours to grow. The decision that takes more than 18 hours sometimes bothers me. I have found that sometimes things take much longer than I would have predicted, and I do apologize on behalf of the Agency for us not cleaning that up earlier.

Senator BURDICK. Are you saying it is impossible to comply with that?

Dr. YOUNG. It was impossible to meet that deadline as it turned out, sir.

Senator BURDICK. When can we expect a final regulation?

Dr. YOUNG. I hope it is momentarily, or within the next few weeks. It is now in the very final stages of analysis within the administration.

ANTIBIOTICS IN ANIMAL FEED

Senator BURDICK. For many years, there has been increasing suspicion that unchecked routine use of antibiotics in animal feed can have health repercussions for the American consumer. The severe outbreaks of Salmonella poisoning have raised concern about the continuation of the broad use of antibiotics in animal feed.

What can be done to protect the public health from drug-resistant bacteria such as Salmonella?

Dr. YOUNG. First, Mr. Chairman, we have been working very hard on this and have completed our internal review within the Center for Veterinary Medicine on the analysis of the information, and I am in the process of developing a contract to get physicians with infectious disease specialization to look at this and answer a single question upon which much of the issue will turn.

That single question is, is a bacterium, Salmonella, for example, that is antibiotic resistant, more likely to produce disease when it is antibiotic resistant than when it is antibiotic sensitive?

I asked the witnesses on the 1-day hearing that I held on the imminent hazard petition approximately a year and a half ago that question. No one was able to answer that question. Until we know whether the antibiotic resistance makes a difference at all in pathogenicity, it is very hard to make the risk management decision.

The second part of your question focuses on what can be done with Salmonella infection of chickens and meat at this time. There are two issues here. First, the government has to determine whether or not there are any real risks, and that is what we are doing.

The second is a real education program for consumers. For example, many of us, regretfully, when we barbecue beef will take the patty off the plate which has a lot of meat juices on it, barbecue it, and put the barbecued patty back on the plate with the juices which have a possibility of being contaminated. That is just wrong.

Chickens have a high degree of Salmonella infection anyway, and is a natural habitat of the organism. When we in our homes process chicken it is important to cook it well, to wash our hands, to not cut the chicken up on the wooden chopping block, and not to fry it or cook it and put it back where the raw meat juices are. There is a lot of education required, and I am preparing for the FDA Consumer, our magazine to consumers, an article coming out this June to deal with food safety, particularly microbial safety.

We are addressing the problem on both levels, and I hope to be able to continue to report to you on this important issue.

Senator BURDICK. Does the FDA continue to support the position that penicillin and tetracycline should be banned from use in animal feed?

Dr. YOUNG. This is what we need to find the answer to. The particular question—is there an increase in virulence of these organisms? If there is, we will certainly move toward examining the appropriate regulatory actions. If there is not, that is a different issue.

So right now, the jury is out.

USER FEES

Senator BURDICK. The fiscal year 1988 budget estimates savings of $34 million resulting from legislation that would grant FDA authority to collect user fees on new product reviews. Almost $26 million of this amount would be collected from human drug and biologic product reviews, with another $8 million collected from medical device manufacturers with products under FDA review.

Has this legislation been sent to the Congress? Would the user fees collected be directly applied to finance FDA activities, or would these fees be refunded to the general fund of the U.S. Treasury?

Dr. YOUNG. The legislation has not been submitted yet, sir. In regard to your second question, if the legislation were passed, not all of the money goes to FDA. The amounts that were listed in the summary of the budget, and I have this year, provides that particular part.

Let me give you the exact figures. Of the almost $26 million for the new drug approval, $1.6 million, and 32 staff-years would go to improve the new drug approval process. The remainder would go for current FDA operations.

Of the $8 million for devices, $600,000 and 12 FTE's would go to increase the productivity of this program. So, basically, there is a split between the two, and all of it goes to FDA but the bulk of the funds go to offset existing costs.

Senator BURDICK. If proposed legislation to implement user fees is not enacted, what is the level of funding that FDA will require in fiscal year 1988?

Dr. YOUNG. We would be in deep trouble if it wasn't enacted, because over 90 percent of those moneys are an offset of our current budget, and we would be in desperate shape if we did not have those funds.

SUBMITTED QUESTIONS

Senator BURDICK. I have additional questions to be submitted for the record; also, for the following Senators: Burdick, Chiles, Domenici, and Bumpers. I would appreciate it if you would respond to them directly in an expeditious manner for the record.

Dr. YOUNG. I would be delighted, and I would be delighted to make any personal briefings of any of your subcommittee, as you so wish, Mr. Chairman.

[The following questions were not asked at the hearing but were submitted for response for the record:]

QUESTIONS SUBMITTED BY SENATOR BURDICK

Contracts and Other Services

QUESTION: Another item detailed in the FDA budget of "Obligations by Object Class" lists "Contracts and Other Services." The Fiscal Year 1988 estimate of $71 million is almost $3.5 million less than the fiscal year 1987 estimate for these services. Please explain what types of contracts and services will be cut back to achieve that $3.5 million savings in fiscal year 1988.

ANSWER: There is no planned reduction in contracts and other services. The estimate of $71 million for this object class, as shown in FDA's budget explanatory notes, was for the amount to be spent with the appropriations requested. When obligations from projected collections of user charges are included, the combined estimate for 1988 is $77 million, which is an increase of about $2.6 million over the 1987 estimate. This combined increase reflects primarily an allowance for inflation in the cost of contractual services generally, as well as a portion of the $1 million increase requested for the National Center for Toxicological Research.

Emergencies

QUESTION: In recent fiscal years, FDA has responded to various and numerous emergencies, consumer complaints, and other unplanned work related to food safety. Although the fiscal year 1988 Budget request includes an additional 20 full staff for food safety activities, the demand for improved surveillance and unforeseen situations may continue to strain FDA resources in spite of the increase in staff. How does FDA intend to detail the additional staff required? (i.e., for import inspections, product tampering, etc.)

ANSWER: The 20 FTEs requested in the food safety area for FY 1988 is primarily intended for additional coverage of imported foods for coverage of microbiological and pesticide residue contamination, and for improved surveillance over dairy products. The precise application of all of our Food Safety resources will depend to some extent on the types of problems encountered during the rest of 1987 and as 1988 progresses.

QUESTION: In fiscal year 1988, how does FDA plan to respond to emergency situations of great magnitude, such as has been the case in fiscal year 1986 with product tampering complaints?

ANSWER: In FY 1986, FDA used about 500 FTEs or about 20% of its total field resources on emergencies and other unplanned work. Based on the first 5 months of the year, we believe only 10-12% of the field's resources will be required for such activities in FY 1987 which is about the same level as that in fiscal years 1983, 1984, and 1985. We plan for 1988 to be similar to 83- Should another year occur with such an extraordinary number of emergencies, we would have to do as we did in 1986 and reduce our regular surveillance activities over regulated products, and utilize the resources in the Contingency Fund.

QUESTION: What is your estimate of product tampering complaints in fiscal year 1987?

ANSWER: Based on our experience through the first half of the year, we would project about 1,200 incidents of tampering complaints or threats in FY 1987. Tampering threats is a relatively new phenomenon we experienced in FY 1986. This compares to about 1,700 tampering complaints or threats in 1986, roughly 900 in 1983 which included the series of events following the Tylenol tampering incident of late 1982, and much smaller numbers in 1984 and 1985.

Contingency Fund

QUESTION: What is the status of FDA's Contingency Fund? Since no request for the Contingency Fund was submitted for fiscal year 1988, how will FDA respond immediately to emergencies?

ANSWER: In FY 1986, the Agency incurred substantial unexpected expenditures in responding to an unprecedented number of emergencies including drug and food products tampering incidents and threats. The $1 million of Contingency Fund monies appropriated in 1983 was available until expended. Of the $1 million originally appropriated, we spent $843,000 in 1986 to cover extraordinary expenses resulting from tampering and food emergencies. Therefore, the $157,000 still available from the 1983 appropriation, combined with the $1 million Congress added to this Fund for 1987, gives us a total of $1,157,000 currently in the fund. So far in 1987, we have not had a situation yet that has required us to use it, and so hopefully this full amount will continue to be available to FDA in 1988.

Imported Food Surveillance

QUESTION: What is the estimated level of resouces in staff years and funding that will be spent on imported food inspections during fiscal year 1987? What is the level projected for fiscal year 1988?

ANSWER: The Agency has allocated about 450 FTE's for the coverage of imported food products in FY 1987 and an estimated 460 FTE's is projected for FY 1988.

Proposed User Fee Legislation

QUESTION: Has FDA estimated the cost of the product review fee that it would assess on human drug and medical device applicants? What is this fee schedule?

ANSWER: Pending Congressional review of the legislative proposal, the agency has not established a detailed fee schedule. The legislative proposal is based on the concept of recovering FDA's full costs of reviewing several types of new product applications for new drugs and medical devices. However, the precise fees to be charged will depend on the final form of authorizing legislation, and a reevaluation of the number of applications being received and of the agency's costs before implementing regulations are published. However, it may be useful to note that the agency's August, 1985, proposal for user charges for new drug applications (NDAs) projected a charge of about $126,000 for each NDA submitted; this was based on the concept of a fixed fee for all NDAs and projected FY1986 costs. Since the agency's costs have risen since that time, it is quite possible that if legislation is passed authorizing these charges in 1988, the average charge per NDA would be somewhat higher. Since the agency has not previously proposed charges for medical device applications, we have less experience with projecting what the charges might be. However, since the most time-consuming type of device application is the full Premarket Approval Application (PMA), and the review of PMAs ordinarily consumes fewer staffyears per application than NDAs, it would be reasonable to project that the charge for PMAs would probably be less than for NDAs.

QUESTION: How would user fees affect the ability of small companies to pursue innovative product reviews? Would these charges inhibit their participation and, over time, stifle advances in medical technology?

ANSWER: In imposing product review charges, the agency does not intend to stifle innovative development of new products. Therefore, our legislative proposal would not charge a fee for the submission of investigational applications--Investigational New Drug exemptions (INDs) and Investigational Device Exemptions (IDEs)--the types of applications that allow clinical studies of new products. User charges would not apply until the product had reached the stage of development where the sponsor believes that safety and efficacy have been demonstrated, and submits a New Drug Application (NDA) or Premarket Approval Application (PMA). In the majority of cases, the submission of an NDA or PMA signifies that the sponsor is prepared to market the product and sees a profitable market for the product; therefore, it is appropriate that a fee for FDA's review be charged at that point.

However, the legislative proposal also includes a proposal for waivers or reductions of the charges under certain circumstances when that would be in the public interest. One instance where reduced or waived fees might be appropriate would be those instances where the developing firm is so small that the product review charge would be an obstacle to submitting the marketing application. Another case where reduced or waived fees would be appropriate would be when the product is intended for a relatively small population and there is less economic incentive to market the product.

Therefore, with the appropriate provision for fee reductions or waivers as included in the legislative proposal, the agency does not believe that the proposed charges would stifle advances in medical technology.

QUESTION: Since the development of human drugs, biologics, and medical devices is conducted under a strict regulatory framework, could not the imposition of user fees for FDA review and approval be viewed as industry-specific taxation?

ANSWER: The proposed product review fees are not intended as industry taxation, and they would not operate like a tax. The firm submitting an NDA, for example, would submit the fee at the same time as the application, as payment for FDA's review activities related to that application. As noted above, charges are not proposed for the submission of investigational applications, only for marketing applications such as NDAs and PMAs. Thus, firms would be paying fees only when they intend to market new products. As a result, fees would apply only to those firms ready to bring new products to market.

More importantly, the product review charges are proposed on a fee-for-service rather than a taxation concept. Unlike a tax, a fee under the proposed legislation would be imposed only on those who filed an application that required a scientific review by the Agency, not on the industry as a whole. The basic principle of the proposal is that the charges are based on FDA's costs, and that the firm submitting an application is simply paying the costs of FDA's review to assure that the applicant has met requirements of law. The submission of an NDA or PMA is voluntary on the part of the sponsor, and in the great majority of cases is based on a clear expectation of future profit--profits which are clearly enhanced by the assurance that FDA approval provides to the users of new medical therapies.

Antibiotics in Animal Feed

QUESTION: Does FDA continue to support the position that penicillin and tetracycline should be banned from use in animal feed? Is FDA undertaking risk assessments to determine how different antibiotics in animal feed affect human health? When will these risk assessments be completed and can we expect regulations to be issued on this issue?

ANSWER: FDA has completed its review of the data generated by recently conducted and FDA sponsored research and other pertinent data on the subtherapeutic level use of antibiotics in animal feeds and other information concerning the public health aspects of antibiotics in animal feeds. Before we can conclude these studies and decide whether to revoke the regulations which allow penicillin and tetracycline to be marketed, I plan to ask a group of outside expert scientists to conduct an independent analysis of the public health significance posed by the use of antibiotics in animal feeds. The study will include information from other independent sources, such as the newly published data from the Center for Disease Control as well as other relevant studies.

QUESTION: One of the requested budget increases for FDA in fiscal year 1988 would provide an additional $1 million to enhance risk assessment efforts. Will these studies be conducted according to improved methodology so as to remove uncertainty in your findings?

ANSWER: The request for $1 million for risk assessment efforts at the National Center for Toxicological Research is not related to the issue of antibiotics in animal feeds. The primary mission of NCTR is to enhance the science of toxicology, primarily by developing better and more efficient means of correlating animal studies of potentially toxic substances to potential human effects. The issue of antibiotics in animal feeds involves complex epidemiological and microbiological questions not directly related to ongoing research at NCTR.

Sulfites

QUESTION: Will the public be adequately protected if the use of sulfites in restaurant foods, such as potatoes, is allowed to continue?

ANSWER: The agency intends to publish later this year a proposed rule on the use of sulfites in potatoes and expects the rule to enhance public protection. The issuance of such a rule, however, will not eliminate the need for that segment of the population that is sulfite-sensitive to exercise caution when eating in restaurants.

QUESTION: Is there need to consider removing sulfites from all restaurant food because, as FDA itself has admitted, labeling of sulfites does not work?

ANSWER: FDA is carefully considering the various alternatives available to it with regard to the use of sulfites in food that is served in restaurants. As you are aware, FDA has already determined that the use of sulfites on fresh fruits and vegetables in not GRAS. The agency is also reviewing the GRAS status of the use of sulfites on potatoes served in restaurants. As for the uses of sulfites on restaurant foods, the agency tenatively considers that labeling of processed foods, coupled with the consumer's knowledge that restaurants use processed foods, will help sulfite-sensitive individuals to avoid exposure to sulfites from these uses.

Regarding the use of labeling or warning statements for restaurant food, the agency has stated that labeling in restaurants (and grocery stores) is not a practical alternative because labeling in this environment is not customarily used, and because of the difficulty of enforcing such labeling requirements at either the State or Federal level.

Sulfites in Drugs

QUESTION: In your testimony, you mention that FDA issued a regulation requiring warning statements in the professional labeling of prescription drugs containing sulfites. Has FDA surveyed the marketplace to determine the extent of voluntary labeling of sulfited drugs? If not, when does FDA plan to conduct such a survey? What percentage of sulfited drugs bear sulfite disclosures?

ANSWER: FDA is making plans to monitor industry compliance with the regulations requiring a sulfite warning statement on prescription drug labeling after the regulation becomes effective on June 3, 1987. Industry trade groups, including the Proprietary Association, the National Association of Pharmaceutical Manufacturers, and the Generic Pharmaceutical Industry Association, have given assurances to the Agency that the industry's efforts at sulfite labeling of over-the-counter drugs through a voluntary program has been successful. While the Agency will continue its efforts to assure that drugs containing sulfites are properly labeled, we do not have as estimate at this time of what percentage bear disclosures.

Sulfites on Chilean Grapes

QUESTION: Beginning this month, a substantial quantity of Chilean grapes will be imported into the United States. Has FDA issued final guidelines on how to determine whether or not these grapes exceed the regulatory standards for sulfites imposed on domestic foods?

ANSWER: On December 29, 1986, EPA announced an interim, one-year policy for the use of sulfur dioxide pesticides on grapes. This policy applies to both domestic and imported grapes. Under this EPA policy, grapes treated with sulfiting pesticides will be allowed to be marketed temporarily without a tolerance level provided that shippers and growers have a valid analysis, using the modified Monier-Williams method, that shows that the grapes contain no detectable residues of sulfur dioxide, i.e., less than 10 parts per million.

EPA's decision was made in consultation with FDA with two objectives in mind: first, to minimize the risk to health of people hypersensitive to sulfites, and secondly, to permit the shipment of sulfite-treated grapes into and within the U.S. pending the development of adequate data to set a pesticide tolerance.

To achieve these objectives, EPA established the following procedures after consultation with FDA:

- Residue of sulfur dioxide on the grapes must be below the current level of detection, that is less than 10 parts per million, when the grapes enter the United States or interstate commerce.

- The shipping containers of both foreign and domestic grapes must be labeled to indicate sulfite residues in accordance with the provisions of the Federal Food, Drug, and Cosmetic Act.
- Shippers, both foreign and domestic, must have certification programs acceptable to FDA to assure that residue levels will be less than 10 ppm. FDA will monitor these programs to assure compliance.
- Any shipment found to have detectable levels of sulfur dioxide will be in violation and subject to seizure or detention by FDA.
- Any shipment of sulfite-treated grapes not covered by a certification program will be deemed to be adulterated and subject to seizure or detention by FDA.

In the case of Chilean grapes, FDA has worked with EPA, USDA, Chilean Government authorities and Chilean growers and shippers to develop appropriate programs.

FDA has issued directives to its field offices to inspect all Chilean grapes. All lots of these grapes are sampled and analyzed for sulfites. Because the level of compliance has been so high, however, the Agency is now considering relying on random sampling and on guarantees from imports that the grapes comply with the 10 ppm requirement.

QUESTION: Is FDA coordinating with other USDA agencies to inspect imported products, such as Chilean grapes?

ANSWER: FDA is working closely with EPA, USDA, and the U.S. Customs in handling Chilean grapes. FDA cooperates closely with several USDA agencies for inspection and certification of a number of imported foods. For example, FDA has specific Memorandums of Understanding with USDA agencies for inspection, examination, and certification of nuts, dried dates and raisins, and shell eggs and egg products. FDA also has a general Memorandum of Understanding with USDA agreeing to cooperate fully in enforcing the various federal statutes that we administer.

AIDS Research

QUESTION: Despite the marked success that FDA has had in the development and approval of the AIDS virus inhibitor, AZT, much more is required to control and, hopefully, arrest the communication of AIDS. The FDA budget requests an increase of $1 million and 22 full-time employees to support and expand AIDS research and review. Understanding the severity of this disease, do you believe that this contribution is sufficient for the task at hand?

ANSWER: FDA's budget request for an increase of $1 million and 22 full-time equivalents appears to be adequate to fullfil FDA's requirements for AIDS related work in 1988. However, as more recent developments occur, such as the rapid accumulation of new data on

AIDS virus and disease and the anticipated escalation of clinical trials for therapy and prevention, FDA, along with other Public Health Service agencies, periodically reevaluates the AIDS program and resource requirements.

QUESTION: Would you expect that if AIDS continues to spread among the world population at its current rate, that by fiscal year 1989, FDA will be requesting further increases for research?

ANSWER: It is possible that FDA may need to further expand its AIDS related activities if the incidence of AIDS continues to spread among the world populations at its present rate. However, the Agency is still reevaluating its 1988 planned activities related to AIDS, and the 1989 budget is just beginning to be formulated. Therefore, it would be very premature to speculate on the Agency's 1989 request at this time.

QUESTION: How can the American public be assured that every pint of blood that is being used for transfusions has been adequately tested to prevent AIDS contamination?

ANSWER: It is not possible to assure absolutely that every unit of blood for transfusion has been adequately screened for antibody to the AIDS virus; however, regular inspections of blood and plasma establishments have failed to reveal one instance in which testing by a licensed (FDA) kit is not being conducted. Thus, except for unknown clerical, technical or administrative errors that may frustrate any system, it can be assumed that all blood and plasma transfused in the United States has been screened for antibodies to the AIDS virus. (The possibility also exists of some untested units of precious red blood cells of rare types frozen prior to test kit availability.)

Investigational New Drugs

QUESTION: Just about two weeks ago, FDA presented proposed regulations for comment on the use of Investigational New Drugs. What has been the reaction of these proposed regulations to date?

ANSWER: There has been broad support for the concept of making promising new drugs available to desperately ill patients as early as possible. There has also been concern raised with a number of specific provisions of the reproposal. The Commissioner and other FDA staff have had a number of meetings with groups of health professionals, consumer groups, industry groups and others to explain the proposal and solicit comment. Because of the high level of interest in these regulations, the comment period was extended to May 5, 1987. The Agency will review again all of the various issues raised before publishing a final regulation.

QUESTION: Are you confident that this new process would provide some hope to desperately ill individuals?

ANSWER: That is certainly our intent, and our recent experience with AZT would help to confirm this. With AZT, a treatment protocol was approved by FDA five months before final approval. In that period, over 4,000 AIDS patients received AZT. That is the model we want to follow--when we have confidence of the promise of the product.

QUESTION: How will the ill be able to avail themselves of the use of these investigational new drugs?

ANSWER: Under the proposal, a sponsor of a drug under investigation that shows promise in the treatment of a serious illness that lacks effective therapy could seek a "treatment protocol," a plan for use of the drug in a treatment setting, which is less stringent that the usual investigational setting. The sponsor would propose the protocol in a submission to his IND and allow FDA 30 days for review. FDA would, on the basis specified in the regulations, approve or reject the protocol, but the intent of the regulation is to allow use so long as sufficient evidence of safety and effectiveness are available. An individual physician, in addition to the sponsor, could also apply to FDA for a treatment IND.

Medical Devices

QUESTION: According to FDA program activity data, the average review time from the date an application for medical device is filed until approval is 13 months, not including delays on additional information requests. Is FDA's request of $600,000 and 12 full-time employees sufficient to significantly reduce this delay in application approval?

ANSWER: Between 1980 and 1985, submissions of premarket approval applications (PMAs) increased nearly 60 percent and PMA supplements by well over 100 percent. If granted, FDA's budget request of $600,000 and 12 FTEs will enable FDA to keep up with increased numbers of PMAs with no additional delay in application review time. The additional resources will also be used to reduce the existing backlog of overdue PMAs. At the same time, the Agency is continuing to pursue initiatives to streamline the review process with the goal of reducing approval times.

QUESTION: What is your estimate of the turn-around time that the budget request, if granted, would afford to new medical device applicants for patents?

ANSWER: Applications for patents, including those for medical device patents, are processed by the Patent and Trademark Office and thus, would not be directly affected by a change in FDA resources. Furthermore, since implementation of the Drug Price Competition and Patent Term Restoration Act, owners of patents for medical devices should no longer be adversely affected by a delay in the processing of their PMA. Under this new legislation, a patent owner can request that their patent be extended for the duration of time that their PMA was under regulatory review. As noted above, the increase requested is primarily intended to assure that the Agency can keep up with rising numbers of device applications. At the same time, the Agency is seeking to reduce the average review time in ways other than by increasing staff. The Agency is also striving to improve processing of other device applications, and the average time for review of Investigational Device Evaluations and Investigational Device Evaluation Supplements was significantly reduced during 1986.

Listeria Contamination

QUESTION: The unfortunate illnesses and deaths resulting from Listeria contaminated cheese is a reminder of how vital the investigations and research of FDA are to the American public. How is FDA monitoring against the importation or domestic production of dairy products contaminated with listeria?

ANSWER: FDA initiated a survey to inspect soft cheese manufacturers nationwide. This survey was conducted in fiscal years 85 and 86 and resulted in the inspection of 406 firms during that period. The survey is ongoing in FY 87 and should be completed by the end of the fiscal year.

FDA survey sample analyses confirmed the presence of Listeria monocytogenes in Liederkrantz and camembert soft ripened cheeses produced domestically by the same U.S. firm. The firm announced a market withdrawal of this cheese. FDA warned consumers to return any cheese with the name Liederkrantz to the place of purchase, and not to eat it.

The Dairy Products Safety Compliance Program began in FY 1986. It includes pathogen surveillance of finished dairy products which will provide information to develop technical assistance efforts. Specifically, the program includes operation of pasteurization plants with emphasis on post-pasteurization contamination, plant system reviews, equipment review and evaluation, and education and training of regulatory and dairy industry personnel. FDA is currently constructing a survey of all U.S. dairy plants to include those producing fluid milk, ice cream, ice cream mixes and similar products. Many of these plants are IMS plants, covered under the agreement between FDA and the Interstate Milk Shippers. Problems identified in these plants are reported by FDA to the State with jurisdiction over the dairy for appropriate action. Non-IMS plants are under FDA regulatory jurisdiction.

The FY 86 results indicate that a low but significant number of pasteurized milk and ice cream products are contaminated with Listeria Monocytogenes, less than 2.5% or 20 of 882 samples. The sixteen positive ice cream samples resulted in product recalls. Four fluid grade A milk positives were referred to appropriate state authorities who took prompt and effective actions.

In February of 1986 FDA warned the public that it had confirmed the presence of Listeria Monocytogenes in samples of Brie soft ripened cheese imported from France. This was accomplished by issuing an import alert on all imported Brie cheese from France.

In March of 1986 FDA initiated surveillance of all imported soft ripened cheese. During FY86, FDA analyzed 786 physical samples of imported soft cheese collected from 15 countries. A rate of 2.6% Listeria monocytogenes positive samples, representing 15 positive samples of 585 analyzed, were detected in French soft chesses. Six additional positive samples were detected from imported cheeses originating from Canada, Federal Republic of Germany, Greece and Italy resulting in product detentions.

In addition, FDA has recently implemented an agreement with the French Ministry of Agriculture to establish a Product Certification Program for Listeria Testing of Soft-ripened Cheese and Goat Cheese wherein the French Veterinary Service Certifies negative in-plant and finished product samples from approved firms under the program. FDA continues to monitor these products and would detain shipments and require the French government to delist participating firms if contaminated product samples were found.

This program has been successful for several reasons. FDA and the dairy industry have learned much about where in the dairy plant problems of microbial contamination may occur. From this, FDA and several dairy industry trade associations have begun close cooperative consultations to determine how best to prevent such problems in the future. FDA has consulted closely with dairy plants which had environmental contamination problems to correct those problems and permit the plants to begin operation as soon as possible. The program has also demonstrated the effectiveness of State-Federal cooperative programs, and the effectiveness and necessity for close Government-industry cooperation.

Urethane (Ethyl Carbamate) Contamination in Alcohol Beverages

QUESTION: Urethane is a well-known and potent carcinogen. Its use in alcoholic beverages prompted Canadian health officials to set limits on urethane contamination in alcoholic beverages over 15 months ago. To date, FDA has not established any limits. Why has FDA not taken action similar to the Canadian government?

ANSWER: Although Canadian officials acted in accordance with their judgement under Canadian law, FDA must address the occurrence of ethyl carbamate (urethane) in alcoholic beverages under the terms of our Federal Food, Drug, and Cosmetic Act (FD&C Act). FDA is still determining how best to do so. To help make this determination, we are gathering information about two factors: (1) the level of human health risk that ethyl carbamate presents, and (2) the extent to which it is possible to avoid ethyl carbamate in alcoholic beverages. The distilled spirits and wine industries have been working to determine the origin of ethyl carbamate in alcoholic beverages and the extent to which it can be avoided.

We must point out that there is no evidence that ethyl carbamate is being directly added to alcoholic beverages. The presence of this substance at some level in some alcoholic beverages is probably unavoidable and has occurred for many years, possibly always. Thus, this problem is apparently an old one that only recently has been identified and publicized.

With ethyl carbamate, as with other substances that cause cancer in animals, the concern is long-term or chronic consumer exposure. FDA's goal is to assure that potential consumer exposure to this substance is reduced to the lowest level technologically feasible. To accomplish this goal, FDA has been working with industry and monitoring the progress of industry's investigations. When the necessary information is available, FDA will determine what actions are appropriate under the FD&C Act. If FDA finds that it is necessary to regulate the ethyl carbamate levels in alcoholic beverages, it is likely to do so under the provisions of Title 21, Code of Federal Regulations, Part 109, which establishes how FDA sets limits for unavoidable substance in foods. Under that section, FDA would establish regulatory limits for ethyl carbamate based on the health risks and the technical feasibility of lowering the level of this substance.

QUESTION: How much of the U.S. alcoholic beverage supply has been tested foe levels of urethane contamination?

ANSWER: FDA and the Bureau of Alcohol, Tobacco and Firearms (BATF) have jointly developed data on the levels of urethane in alcoholic beverages. In the latter half of 1986, the two agencies sampled a random cross-section of domestic wines and distilled spirits, although BATF did analyze at least one sample from most domestic bourbon producers. BATF has not provided us with information to determine what portion of the U.S. alcoholic beverage supply was tested in this sampling. In actual numbers however, FDA analyzed 116 domestic wines, and BATF surveyed 112 distilled spirits for urethane content. The following ranges of urethane levels were obtained: table wines-not detected to 270 ppb; sherries-16 to 450 ppb; ports-not detected to 170 ppb; bourbon-16 to 394 ppb; brandy-not detected to 2,886 ppb; non-bourbon whiskey-not detected to 238 ppb; rum-not detected to 114 ppb; and vodka-not detected. Additional testing of alcoholic beverages is continuing.

QUESTION: What is FDA doing to test the remainder?

ANSWER: FDA is working in close coordination with BATF in surveying alcoholic beverages for urethane content. BATF is continuing active testing for urethane in wines and distilled spirits collected as part of their general surveillance and compliance monitoring programs. FDA is conducting investigative analyses for urethane in low alcoholic content beverages such as beer. FDA and BATF are also working closely with the distilled spirits and wine industries to monitor the progress of their investigations aimed at reducing urethane to the lowest levels technologically feasible.

√ QUESTION. When will FDA release its urethane test results as it has done with other test results such as nitrosamines in beer in 1979?

ANSWER. FDA's test results for ethyl carbamate in alcoholic beverages are made available to individuals who request them under the Freedom of Information Act. FDA, however, is not yet prepared ✓ to officially publicize~~d~~ these test results. Unlike the case of nitrosamines in beer, we do not have a representative sampling of all alcoholic beverages for ethyl carbamate at this time. Furthermore, the risk to consumers from these ethyl carbamate findings is presently unclear. In light of these facts, we believe that to publicize partial test results without being able to provide a clear explanation of what they mean may lead to erroneous interpretations by consumers.

QUESTION. What level of urethane in alcoholic beverages does FDA consider to present unacceptable lifetime risks of cancer to a moderate consumer of contaminated beverages?

ANSWER. FDA has not yet determined the level of ethyl carbamate in alcoholic beverages that presents an unacceptable lifetime risk of cancer. The Agency is still gathering information concerning the level of human health risk that ethyl carbamate in alcoholic beverages presents.

We must point out that a risk assessment is based on two elements: the toxicity data and the exposure data. The information describing the toxicity of ethyl carbamate consists of lifetime animal feeding studies showing that it is an animal carcinogen. In almost all of these studies showing that it is an animal carcinogen. In almost all of these studies, ethyl carbamate was administered to animals in aqueous solution. We have recently received results from a preliminary toxicological study that suggest that alcohol may inhibit the carcinogenicity of ethyl carbamate in mice. The significance of these data for humans in unclear.

Our knowledge of the extent of human exposure to ethyl carbamate is based on information on the level of consumption of the various alcoholic beverages as well as the ethyl carbamate levels that occur in the beverages. The data that have been generated on ethyl carbamate in alcoholic beverages show that there is significant variability in the levels found in different batches of some products. Because of this variability, the extent of human exposure to ethyl carbamate has not been clearly established.

Considering the nature of the information described above, the risk to humans from ethyl carbamate in alcoholic beverages is at present uncertain.

QUESTION. Is FDA taking steps to assure that consumers avoid products containing urethane in excess of that level?

ANSWER. We have not altered consumers to the presence of ethyl carbamate in some alcoholic beverages because the extent of the risk to consumers is presently unclear, and because the origin of ethyl carbamate and the extent of its unavoidability in alcoholic beverages is currently unknown and under active investigation. Given this situation, we believe that it would be premature to make an official pronouncement to consumers. In addition, because the available data show that there is significant variability in ethyl carbamate levels in different batches of some products, and because we do not have a representative sampling of all alcoholic beverages, we feel that we cannot provide reliable and defensible advice to consumers to avoid specific brands of alcoholic beverages.

There have been numerous media reports concerning ethyl carbamate in alcoholic beverages. These reports have provided consumers with general information on the issue. As follow-up to these reports, we have received and responded to inquiries from consumers and the media on the subject and will continue to do so.

QUESTION. When does FDA plan to make a public decision on urethane contamination levels?

ANSWER. Because of the unpredictable nature of the research being carried out by industry, we have not established a timetable for reaching a decision on the ethyl carbamate levels in alcoholic beverages. While the wine and distilled spirits industries continue their research, we will continue to work with them. We will also explore other regulatory options in the event that progress in solving the problem appears to wane.

Ban on Interstate Sale of Raw Milk

QUESTION: Recently, a U.S. District Court concluded that in 1984 the Department of Health and Human Services acted in an "arbritraty and capricious" manner by disregarding certain risk data nd not banning the sale of raw milk between states. Will FDA appeal this district court decision? What position is FDA taking with respect to the interstate sale of raw milk in the future?

ANSWER: Shortly after the above-noted court decision, FDA requested the court to amend certain aspects of its ruling. The court issued an amended order calling for FDA to issue a notice of proposed rulemaking to ban the interstate sale of raw milk. FDA is considering whether to appeal the amended order. Regardless of its decision about appeal, the agency in the near future will publish a notice of proposed rulemaking in complaince with the amended order.

Plant Closings

QUESTION: FDA has analyzed the costs and savings associated with closing several of its field laboratories, but has been prohibited by Congress from implementing plant closures in fiscal year 1987.

Will FDA reinstitute its plan for plant closures in fiscal year 1988? If so, will a request for any associated expense be submitted to Congress in advance? If FDA intends to consolidate and close existing laboratories, how will the workload and staff resources be redistributed? What laboratories will provide what type of specialized work? If FDA persues its plan for plant closures, will full-time staff be reduced? If not, how will these staff be accommodated?

ANSWER: FDA does not plan to close any field laboratories in 1987, nor have any funds been requested for this purpose in 1988. Furthermore, we are holding our consolidation plan in abeyance pending further review, especially of the results of the GAO report.

We are cooperating fully with GAO on their study. However, we continue to believe that some consolidations would produce significant saving in the long run.

We also believe consolidation would help us make more productive use of the remaining facilities. With the number of facilities we have now, there is simply too much laboratory space that is not being used.

Planned consolidations would eliminate only about 40% of the currently excess capacity, leaving us some room for changing program needs.

Closing some of the laboratory sections of our district offices would not affect FDA's presence in any of those cities--we would have the same number of investigators and other field staff in those locations to conduct our normal inspectional activities, collect product samples, deal with emergency situations, and provide assistance to the public and to the States.

We do not beleive that closing a few of the laboratories would impair our sample analysis capabilities. All samples collected must be carefully packed for transport in any case, and many of them are already shipped to the laboratory best able to conduct the testing expeditiously. However, changing workloads due to newly emerging problems may affect our choice of laboratories currently under consideration for closing.

If a decision is made to close some Field laboratories, all laboratory staff involved would be reassigned to other Field laboratories, depending on program needs, the extent to which the remaining laboratories have bench space available, and depending on the skills of the employees involved. The agency does not plan any reductions in staffing related to possible laboratory closings; the purpose of the agency's study of possible laboratory consolidation is to reduce the amount of unused laboratory space, and thereby reduce costs.

If any laboratories are eventually closed, most of the specialized functions within certain Field laboratories would remain where they are now. The specialized functions of any laboratories to be closed would be reassigned to other laboratories depending on the best combination of space and skills available. The precise distribution of specialized laboratory work will have to be reevaluated in light of the pending GAO report, and will depend on the decision on whether to close any of the laboratories, and if so, which ones and how many.

QUESTIONS SUBMITTED BY SENATOR BUMPERS

User Charges

QUESTION: Commissioner Young, I appreciate your appearing before the Subcommittee today. I would like to address two issues that I find troubling, user fees and the regulatory classification of certain medical devices.

I understand that the Administration will propose legislation requiring FDA product review charges, or user fees. I question the legal authority of the FDA to impose these charges for the premarket approval process for reasons I will spell out. I have long been interested in regulatory reform, and am glad to say that Senate shares my interest in this matter since the Bumpers Amendment to the Administrative Procedures Act has been overwhelmingly approved by that body in the past. And as Chairman of the Samll Business Committee, I am concerned about the effect of FDA actions on the small business community.

Title V of the Independent Offices Appropriations Act of 1952 authorizes federal agencies to recover the agency's costs by charging the persons receiving the services. The Bureau of the Budget (now OMB) Circular A-25 sets forth guidelines for agencies' implementation of user fees. It states that such charges are appropriate where the federal government "provides special benefits to an identifiable recipient above and beyond those which accrue to the public at large." It also states that "no charge should be made for services when the identification of the ultimate beneficiary is obscure and the service can be primarily considered as benefiting broadly the general public."

There is no doubt in my mind that the FDA's premarket approval activities for new drugs and devices exists for the benefit of the consuming public rather than for applicants who wish to market new drugs. Certainly the companies developing these products benefit if they are approved, but the greatest beneficiaries are the public. If new products are not approved, the public benefits through protection from potentially unsafe or ineffective products.

Even if we assume that the FDA *does* have the authority to impose user fees, I would direct the FDA's attention to the Regulatory Flexibility Act. That Act compels the federal agencies, including the FDA, to adopt less burdensome user charges and procedures for small businesses. It requires the head of an agency, if he or she finds "significant economic impact upon a substantial number of small entities", to include reasonable regulatory alternatives which minimize the potential economic burden on small business. My question is this: Has the FDA fully considered the devastating impact that user fees would have on the small drug and device producers and research companies of this nation?

In 1982, there were over 800 firms manufacturing or processing pharmaceutical preparations. The vast majority employed fewer than 50 workers. In addition, many small businesses develop and promote new drugs and medical devices. User fees will likely prevent many small businesses from filing applications and entering the market. An upfront fee of $126,000 might be small change to large corporations, but it could well be an insurmountable obstacle for a small firm.

The losers, shoud users charges be imposed, would be small business and the general public.

ANSWER: In imposing product review charges, the agency does not intend to stifle innovative development of new products. Therefore, our legislative proposal would not charge a fee for the submission of applications at the investigational stage--Investigational New Drug exemptions(INDs) and Investigational Device Exemptions (IDEs)-- the types of applications that allow clinical studies of new products. User charges would not apply until the product had reached the stage of development where the sponsor believes that safety and efficacy have been demonstrated, and submits a New Drug Application (NDA) or Premarket Approval Application (PMA). In the majority of cases, the submission of an NDA or PMA signifies that the sponsor is prepared to market the product and sees a profitable market for the product; therefore, it is appropriate that a fee for FDA's review be charged at that point.

However, the legislative proposal also includes a proposal for waivers or reductions of the charges under certain circumstances when that would be in the public interest. One instance where reduced or waived fees might be appropriate might be those instances where the developing firm is so small that the product review charge would be an obstacle to submitting the marketing application. Another case where reduced or waived fees might be appropriate would be when the product is intended for a relatively small population and there is less economic incentive to market the product.

Therefore, with the appropriate provision for fee reductions or waivers as included in the legislative proposal, the agency does not believe that the proposed charges would stifle advances in medical technology.

As noted above, charges are not proposed for the submission of investigational applications, only for marketing applications such as NDAs and PMAs. Thus, firms would be paying fees only when they intend to market new products. As a result, fees would apply only to those firms ready to bring new products to market. The proposal also does not include proposed charges for Abbreviated New Drug Applications for generic drugs.

Contact Lenses

QUESTION: Last year I asked a number of questions regarding the classification of certain medical devices. I pointed out that daily wear contact lenses were still regulated as Class III devices -- in the same category as cardiac pacemakers -- in spite of the fact that the FDA's own expert panel, the American Optometric Assocaiation, and the American Academy of Ophthalmology have recommended that they be reclassified. I know of no change in the position of any of these experts.

Your reply last year to my question of whether FDA's resources could be put to better use than the lengthy premarket approval of daily wear contact lenses was a qualified "yes". I suggest that the answer to that same question this year should be an unqualified "yes".

In the FDA's Justification for Appropriations Estimates for the Committee, you say that the sum of $1 million for review of premarket approval applications we appropriated last year will not be sufficient. Frankly, this disturbs me. These scarce funds are supposed to be applied to review of "major new technologies" as intended by the law and stated in this committee's report of last year. Yet, you are still devoting a substantial portion of these funds to such things as rigid contacts and cleaning solutions.

I appreciate and support the FDA's caution in most areas. The public health is your first consideration. But I have heard no evidence that the common rigid or gas permeable contact lenses are a danger to the public health. I can find no evidence of adverse reaction to these products or to the cases designed to hold them, which are also regulated in class III.

Placing a contact lens case in the same regulatory classification as a cardiac pacemaker simply does not make sense. I understand that the medical device used to fill an eyeball emptied surgically is less stringently regulated than a daily wear contact lens. And I have learned that the FDA may soon reclassify ophthalmic lasers and artificial hip joints.

The upshot of this classification is two-fold. It increases the costs to consumers and it weighs heavily against the small manufacturers which have a tremendous record of both innovation and safety. Is it possible that the present high classification of rigid contact lenses may have more to do with anti-competitive concerns than with the public health?

I suggest that an average of nearly a year is far too long for a small manufacturer to wait while the FDA studies a product that experts believe to be safe and effective enough to reclassify. Not many small businesses can hang on that long while awaiting approval of their products.

I appreciated the support of the FDA for our legislation last year designed to bring about reclassification of contact lenses. It was fortunate that the measure was introduced too late to receive Senate consideration. I hope you will be even more effective in your support this session so that we can correct the situation and let FDA use its resources more effectively for the public benefit.

I would appreciate your considering my concerns, and I look forward to a response from the Food and Drug Administration.

ANSWER: As you know, non-PMMA contact lenses are Class III devices requiring premarket approval because the statute classifies devices that were regulated as "new drugs" prior to the Device Amendments, such as contact lenses, into that class, and because we have been unable to obtain the requisite safety and other data from the public domain to justify reclassification. To be sure, regulating contact lenses through the premarket notification(510k) process would be less resource intensive than is the case now.

As you know, FDA has the authority to reclassify devices. We proposed reclassifying daily wear soft and rigid gas-permeable contact lenses in 1982, but after reviewing the publicly available data, we concluded that not enough information existed in the public domain to permit reclassification. Contact lens manufacturers have been unwilling to publicly release the kinds of information which would allow the Agency to reclassify contact lenses. The Contact Lens Manufacturer's Association challenged FDA's decision to withdraw the reclassification proposal but the decision of the lower court against the trade association was upheld by the U.S. Court of Appeals for the D.C. Circuit. FDA's decision was based in part on lack of sufficient publicly available information to support reclassification. By way of contrast, the Agency is currently considering reclassifying certain ophthalmic lasers, based in part on information made available by a group of laser manufacturers. At this time, however, FDA does not have enough information to consider reclassifying the contact lenses in question.

If information that FDA is not aware of exists which would support reclassification of contact lenses, FDA is certainly willing to condsider it. Any individual or group may petition the Agency to consider reclassification. While it is true that at the time FDA withdrew its proposed reclassification, sufficient public information was not available, experts working in this field may collectively or individually have the necessary information to sustain a reclassification. Such a decision could be a boon to both consumers and manufacturers provided that the necessary assurances of safety and effectiveness for the wearers of rigid or gas-permeable contact lenses are met.

QUESTIONS SUBMITTED BY SENATOR CHILES

Adulterated Orange Juice

QUESTION: The Florida citrus industry and the Food and Drug Administration (FDA) have struggled for sometime with developing a good method for detecting adulterated orange juice. As you know, the Florida Department of Citrus and the FDA entered into a contract with Arthur D. Little, Inc. for collection and preparation of authentic orange juice samples. This is very important work as it is necessary to develop a data base on authentic orange juice before the FDA can take advantage of the new detection techniques. How does FDA plan to fund the third year of sampling required under FDA's proposal?

ANSWER: FDA has not committed any funds, at the present time, for a third year's collection of authentic orange juice samples. There are two reasons for this. FDA has targeted its research funds primarily toward food safety. Secondly, we would like to wait until we have completed the collection and analysis of the data on the samples already collected and the further evaluation of two situations - the increasing importation of juice concentrates and the increasing "fresh-squeezed" juice market - before developing the sampling plan for additional sample collections.

FDA has committed substantial resources, in both staff and funds, to the completion of this project. In June of 1984, FDA contracted with Arthur D. Little for the collection and preparation of authentic orange juice samples. This contract was to have expired on December 19, 1985, but was extended at no additional cost to the government until June 19, 1986, to complete the collection of designated samples which had not been available prior to the December 19th expiration date. The contract was funded for $461,287. An additional $125,000 has been provided by the State of Florida to fund the collection of 32 additional authentic samples to fill in gaps in the first year's sampling plan. The Arthur D. Little contract was subsequently modified and expires on July 31, 1987.

QUESTION: Could you please provide me with a statistical analysis of the ability of the various methods to detect adulterated orange juice?

ANSWER: Using the statistical method of Cohen to rank the methods of analysis used to distinguish adulterated orange juice from authentic orange juice in our Phase II study, from the most effective to the least effective, the ranking is as follows: high performance liquid chromatography (HPLC), inductively coupled plasma emission spectrometry (ICP), Fourier transform infrared spectrometry (FTIR), synchronous scanning fluorescence spectroscopy (SYNC SCN FL), Fourier transform carbon-13 nuclear magnetic resonance spectroscopy (FTNMR), ultraviolet-visible spectrometry, enzymatic analysis, capillary gas-liquid chromatography (GLC). The table below provides a summary of the statistical analysis of Cohen. The following reprint from the November 1986 issue of Food Technology identifies the components of orange juice that are measured by the various methods.

QUESTION: Could you give me an update on your progress with the intentionally adulterated orange juice project with an accompanying statistical analysis?

ANSWER: To date, forty-seven "intentionally" adulterated orange juice samples have been prepared and analytical data collected for them. Our current sampling protocol plans for approximately 125 intentionally adulterated samples for our Phase III study. Valid computer data analyses cannot be made until a more complete set of analytical data has been obtained. When we have completed these analyses, we will be happy to provide copies of the results.

[The information follows:]

Tab A

METHOD RANKING

Based on Evaluation of Phase II Data
(SIMCA)

METHOD	RANK	COHEN'S K ± S[*]
HPLC	1	.98 ± .11
ICP	2	.91 ± .11
FTIR	3	.92 ± .24
SYNC SCN FL	4	.64 ± .22
FTNMR	5	.83 ± .25
UV ABS	6	.60 ± .24
ENZYME	7	.56 ± .12
GLC	8	.36 ± .09

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[*] Cohen, J. (1977) Statistical Power Analysis for the Behavioral Sciences (Rev. ed.), New York, Academic Press

PATTERN RECOGNITION METHODS FOR THE DETERMINATION OF FOOD COMPOSITION

By Samuel W. Page

Tab B

[From Food Technology, November 1986]

☐ THE APPLICATION of computer pattern recognition methods is a scientific approach to the study of complex systems. Pattern recognition is basically the mathematical analysis and modeling of multivariate data to infer or predict properties of a system from indirect measurements. These methods have been pioneered by several chemometrics groups, including those headed by Bruce R. Kowalski, University of Washington, Seattle; Svante Wold, University of Umea, Sweden; Peter C. Jurs, Pennsylvania State University, University Park; and Désiré L. Massart, Vrije Universiteit Brussel, Brussels, Belgium. Several excellent reviews include those edited by Martens and Russwurm (1982) and Kowalski (1984) and those by Varmuza (1980a; b) and Jurs (1986). The following discussion will focus on applications of pattern recognition in the general context of food composition, with our research on the determination of orange juice adulteration as a working example.

Food Composition Analysis

The universe of food composition may be described as resulting from four major factors. Primary among these is the inherent genetic control, which will certainly become an increasingly important consideration with the application of genetic engineering to food plants and animals. The second factor is the environmental component, which includes soils, climate, and coexisting organisms such as fungi. The third factor is the agricultural component, which is the result of practices used in food production—cultivation, irrigation, animal feeds and drugs, use of pesticides, and harvesting practices. The fourth factor is processing, which includes the postharvest manipulations of the food product, such as preservation practices, use of food additives, and conversions to other food forms, e.g., fruit juice. These four factors can be labeled in multidimensional terminology the "cause" space of food composition (Forina and Lanteri, 1984).

While these factors are certainly definable, in many cases they are difficult to infer from the food composition. Even for a specific food item, they may vary significantly. The food composition resulting from them not only may be "multivariate," but may also be nonlinear with respect to these factors.

The composition of a food, in turn, affects such often obscure properties of the food as its salubrity—its content of nutrients, fiber, intrinsic toxicants, and contaminants. This is certainly the property of most concern. Another factor particularly relevant to the Food and Drug Administration is the authenticity of food products; this is the property of orange juice that we are attempting to infer. Other effects of food composition are the sensory quality and stability, which are of major marketing concern. The sensory quality and salubrity may also be related to the product stability. These four factors can be described as the "effect space" of food composition. They are usually difficult to describe quantitatively.

Food composition can be qualitatively and quantitatively defined by physical and chemical measurements. Since most foods are complex mixtures of many often unknown and variable constituents, the characterization of foods requires many measurements. The classical univariate approach is to reduce each problem to one (or a few) variables and measure these variables as accurately as possible. This will work well for such food components as specific nutrients or contaminants. However, this "reductionist" mind-set cannot be expected to address multivariate food composition problems. These are best solved by the combination of multivariate characterization and multivariate data analyses.

A mathematical description of this concept is $S = (X_1, X_2, X_3, \ldots, X_n)$, where an object or sample S is described by a number n of individual descriptors or variables X, which are the physical and chemical measurements that are made for that sample. Each variable (or combination of variables) defines one axis or vector component and can be considered a dimension in space, with the dimensionality of the sample corresponding to the number of variables or features. This n-dimensional data set for the sample can be represented as a point in the n-dimensional space defined by the "pattern" vector. With the basic assumption that there are underlying patterns in the data, samples with similarities in a certain property or properties or in interproperty relationships will be closer together in this pattern space.

Pattern Recognition

In the analytical approach described by Kowalski (1983) and others, measurements are made on samples to yield data. In a univariate approach, these data can be converted into information about the samples, such as concentrations of specific components. Describing a system of samples requires calculation of averages, standard deviations, and other relationships. But for the most part, the measurements are considered one at a time. For multivariate systems, the univariate analytical approach far too often stops at this point. Important information may exist in relationships among several variables. The conversion of isolated information about the composition of the system cannot be translated into the desired knowledge of the properties of that system.

In pattern recognition and other multivariate statistical methods, many variables or descriptors can be examined simultaneously. This process can therefore lead to the solution of multivariate problems. Using these methods, the conversion of information contained in indirect measurements can be converted to the desired knowledge of properties of that system. In some cases, multivariate analytical data can be converted directly into knowledge of the properties of the system. However, there are pitfalls in such shortcuts. It is preferred, particularly in exploratory development, to convert the measurement data into information for validation and to make certain that this information relates logically to the problem at hand.

Since many food composition problems, such as the determination of salubrity, authenticity, or sensory quality, involve "classifications" based on indirect measurements, pattern recognition methods are obvious choices for data analysis. Sensory evalutions are, in fact, "pattern recognition" methods. In olfactory evaluations, for example, the nose is the "detector" collecting the data, and the brain is the "computer," comparing the "test" sensory "pattern," often with very subtle and complex differences, to those of previous experiences, "the training set." In addition to the main objective of sample "classification," pattern recognition methods can assist in maximizing data utilization by:

- Extraction of the most useful information from the data, including the recognition of bad data and the salvaging of more information from poor data.
- Improvement of the selection of more suitable analytical measurements.
- Improvement of the description of nonphysicochemical variables of system properties.
- Improvement of sample collection design.

In pattern recognition methodology, these objectives are met by determining sample relationships, including outliers, determining variable relationships, and developing and optimizing classification models.

There have been a number of examples of applications of pattern recognition to food chemistry problems (Martens and Russwurm, 1982; Forina and Lanteri,

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The author is Supervisory Research Chemist, Div. of Contaminants Chemistry, Center for Food Safety and Applied Nutrition, Food and Drug Administration, 200 C St., S.W., Washington, DC 20204

1983). These include the geographic classification of olive oils (Derde et al., 1984), orange juices (Bayer et al., 1980), and wines (Kwan and Kowalski, 1978; Noble et al., 1980; van der Voet et al., 1984; Moret et al., 1984); authentication of Scotch whiskies (Saxberg et al., 1978) and essential oils from hops (Stenroos and Siebert, 1984); and analysis of sensory evaluations (Kwan and Kowalski, 1980). It should be noted that, for the most part, pattern recognition analysis of the data was an afterthought. To maximize the effectiveness of pattern recognition methods, the analytical process must be planned and developed considering the sampling requirements and the broad spectrum of measurement possibilities, which, in many cases, because of their complexity, only multivariate methods can utilize. In fact, the majority of the failures of pattern recognition methods (e.g., Varmuza, 1980b; Pijpers, 1984; Clerc and Szekely, 1984) can be attributed to the lack of appropriate sampling and/or to the measurement of data that do not contain information related to the problem. The requirements for sampling and analytical measurements are no less rigorous than for classical univariate methods.

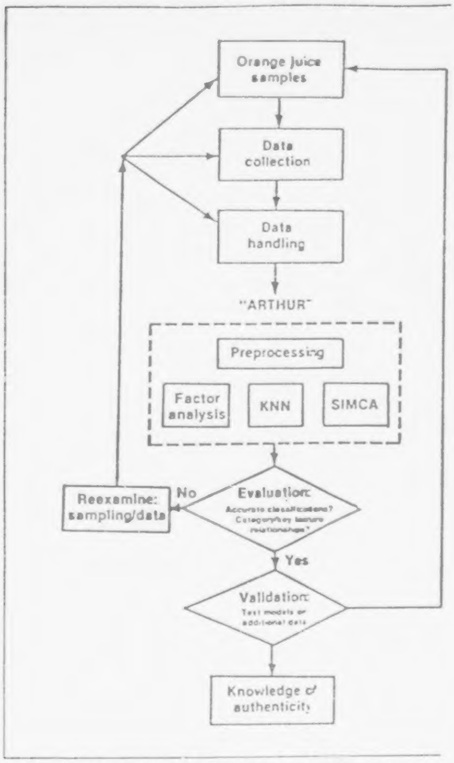

Fig. 1—The Analytical Process Using Pattern Recognition

Determination of Orange Juice Adulteration

The analytical process outlined above is elaborated in Figure 1 to describe our application of pattern recognition methods to the determination of orange juice adulteration. This program was divided into three phases. Phase 1 was a feasibility study which included familiarization with and evaluation of pattern recognition computer programs and evaluation and development of analytical techniques and computer analyses for a limited number of samples. Phase 2 was a pilot study, which included further refinement and evaluation of the analytical methods and the analysis of orange juice samples representing variations in geographic origin, variety, and adulteration methods. Phase 3, the validation of these procedures, is currently in progress.

- **Samples.** In the design of sampling plans for pattern recognition studies, the important consideration is that the samples must be representative of the class(es) being modeled—not just of the entire sample universe. For example, 80–90% of the frozen concentrated orange juice (FCOJ) marketed in the United States comes from Florida. A large percentage of this juice is from Valencia oranges. If our objective was to model the entire FCOJ market, obviously a substantial majority of the samples would have to be from Florida Valencia oranges. However, a model developed for this juice would not necessarily fit an equally authentic juice made from California Valencia and navel oranges.

Since the objective of our research is the determination of authenticity, the sampling plan must be designed to make certain relationships such as those among different geographical sources and orange varieties are adequately represented. Table 1 lists the geographic and varietal "authentic" samples for Phase 3. Some of these will be examined for seasonal variation and for the effects of processing variations. The types of "adulterated" samples being studied are (1) simple additions, including sugar/acid addition; (2) citrus by-product addition; (3) grapefruit juice (including debittered) additions with sugar/coloring; and (4) "sophisticated" recipes. In addition, quality assurance check samples, samples for decomposition studies, "fresh-squeezed" samples, authentic blends, and commercial samples (including those from other countries) will be analyzed. Proper maintenance and monitoring to ensure sample integrity must also be included as a proper sampling requirement.

- **Relevance of Data.** Another key requirement of pattern recognition studies is that the measurement data be relevant to the problem at hand. In designing the study, the scientist must decide what parameters might be important for the properties of concern. For example, the composition of orange juice in light of the possible methods of adulteration was examined. More than 99% of orange juice is water, sugar, and organic and amino acids. These are attractive as adulterants because they are inexpensive and can be added to simulate the "authentic" compositions. Therefore, measurement data which reflect components that are more difficult to duplicate or remove (e.g., trace elements, carotenoids, polysaccharides, etc.) must be obtained.

The analytical techniques evaluated in Phases 1 and 2 and the orange juice components which they measure are given in Table 2. These are listed in order of their classification accuracies in distinguishing between authentic and adulterated juices in the Phase 2 studies. Reported studies of amino acid compositions of fruit

Table 1—Authentic Orange Juice *samples for geographic and varietal variations*[a]

Arizona
- Valencia

California
- Valencia
- Washington navel

Florida
- Dancy
- Hamlin
- Murcott
- Parson Brown
- Pineapple
- Tangelo
- Temple
- Valencia (rough lemon root stock)
- Valencia (sour orange root stock)

Belize
- Pineapple
- Valencia (rough lemon root stock)
- Valencia (sour orange root stock)

Brazil
- Gravo
- Hamlin
- Murcott
- Natal
- Pera
- Valencia
- Washington navel

Mexico
- Hamlin
- Valencia
- Corriente

[a] Representing majority of U.S. market; multiple samples at multiple locations

Table 2—Analytical Methods for pattern recognition studies

High-performance liquid chromatography	34 data points: carotenoids, flavones, flavonoids
Inductively Coupled Plasma Emission Spectrometry	10 data points: trace elements
Fourier Transform Infrared Spectrometry	40 data points: polysaccharides, polyuronides
Synchronous Scanning Fluorescence Spectroscopy	6 data points: flavonoids, polyphenols
Fourier Transform Carbon-13 Nuclear Magnetic Resonance Spectrometry	49 data points: sugars
Ultraviolet-Visible Spectrometry	29 data points: flavonoids, polyphenols, carotenoids
Enzymatic Analyses	6 data points: organic acids, sugars
Capillary Gas Chromatography	13 data points: fatty acids, sterols

juices (Ooghe and de Waele, 1982; Nelson et al., 1984) have shown some discriminating information; this would be useful data to examine for our samples. However, during our studies, an adequate amino acid analyzer system was not available. The poor discrimination of the nuclear magnetic resonance (NMR) and enzyme data most probably results from the fact that these techniques measure primarily simple sugars and organic acids. Therefore, they contain insufficient information relative to the problem of distinguishing "authentic" juices from adulterated juices prepared by adding pulpwash or other adulterants.

• **Validity of Data.** The third key factor in the application of pattern recognition methods is the validity of the analytical measurements—experimental variations must be controlled. Since the measurements may be only indirectly related to the property of the given class, absolute measurement values are not always required. The important consideration is that the analytical methods be standardized with appropriate calibration and internal standards. As a precaution against non-constant systematic measurement errors resulting in misclassifications, the samples in one class should not all be analyzed at the same time. The poor performance of the capillary gas chromatographic method—as indicated by its being ranked lowest of all the techniques in our evaluations—may to a large extent have resulted from problems with the injector system. (These problems were subsequently corrected [Stack et al., 1986], but the samples were not available for reanalysis.)

• **Computer Data Analysis.** The primary tool in our pattern recognition studies has been the computer program package, "ARTHUR," an interactive collection of more than 70 routines for analyzing multivariate data. This software was assembled and developed by Professor Bruce R. Kowalski's group at the University of Washington and is currently maintained and distributed by Infometrix, Inc., Seattle, WA. Some chemometricians have suggested that such multivariate computer methods will not be accepted by practicing chemists or food technologists until these methods are available in a "black box" (see Borman, 1982). While we have worked with Infometrix to make ARTHUR more "user friendly," the black-box philosophy applied to these methods can be dangerous. While all of these methods are based on sound mathematics and statistics, the results must make sense with regard to the relationship of the measurements to the properties being determined, and there are hazards associated with their casual application.

The routines in ARTHUR can be divided into five elements, as shown in Figure 2 (Infometrix, 1985). The functions highlighted are primarily those which we have used in our studies. The first element, preprocessing, is the "Rosetta Stone" for the computer analysis. The success of the computer data analysis can be very dependent on the organization, editing (including corrections for missing data), and normalization of the data. Since the measurement units for the data are usually different, these variables must be standardized. This is accomplished by scaling (Johansson et al., 1984). This element also contains methods for merging data files and other preliminary data refinements such as data reductions.

The second element contains the routine for plotting the results of the data analyses, including a nonlinear mapping display technique. The third element, dimensionality, is used to analyze for relationships among the variables and to reduce the "dimensionality" or number of variables of the data set. These include eigenvector rotation and factor analysis routines.

The fourth element, unsupervised learning methods, is used when no classes are known and indication of systematic behavior of the data is required. Since we are studing the classification of orange juice in "adulterated" or "authentic" categories, unsupervised learning techniques have not been applied.

The fifth element, supervised learning methods, is

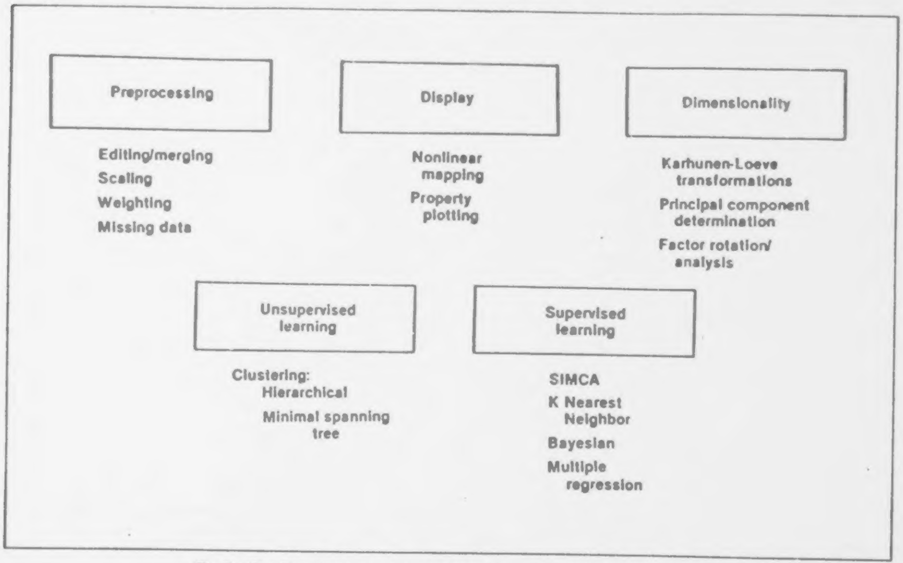

Fig. 2—The Five Elements of the ARTHUR software package (Infometrix, Inc.)

the heart of our pattern recognition analyses. We have used primarily the modeling routines SIMCA (*S*tatistical *I*solinear *M*ulticategory *A*nalysis, *S*imple *M*odeling of *C*lass *A*nalogy, or *S*oft *I*ndependent *M*odeling of *C*lass *A*nalogy) and KNN (*K* *n*earest *n*eighbor). In SIMCA analyses, classification models are constructed by principal component analysis of data vectors of the training data. The unknowns ("test") are assigned to known categories by the similarity of the vector to the class principal component model. An advantage of SIMCA is that samples that do not fit any of the known or training categories can be treated as outliers without affecting the other category assignments. KNN classifies unknown data vectors on the basis of intersample distances to the known or training set data vectors. The test or knowns are classified by the majority of K nearest neighbors.

- **Evaluation of Data.** The critical section of our analytical flow chart (Fig. 1) is the evaluation of the pattern recognition analyses. Are we able to accurately classify the test samples? If not, are our samples representative? Are the analytical data relevant to the problem at hand? Are the measurements valid? If we are able to classify accurately in exploratory data analysis, we next examine the key features of the classifications. The basic relationships of the sample classifications and analytical measurements must make sense. If the authenticity of the juices was correlated with the shoe size of the orange picker, for example, something would obviously be wrong.

Table 3 shows some of the classification results obtained with our Phase 2 trace element composition data. Such data obviously contain information relevant to differentiating between adulterated and authentic samples, since the trace element composition of citrus differs from that of adulterants such as beet sugar or water dilution. From the report of Bayer et al. (1980), trace element composition also may reflect geographic origin. This is illustrated in Figure 3, which is a projection of the Fisher-weighted data (Infometrix, 1985). Table 4 shows the SIMCA results for some of the preliminary Phase 3 high-performance liquid chromatographic data. Since profiles of the flavonoids and carotenoids would be expected to be characteristic of particular types of citrus and would reflect any changes in composition resulting from processing and several other factors, these excellent correlation results are not unexpected. We are developing the HPLC technique with a personal computer pattern recognition program for use as a screening method.

Future Prospects

We are now in the validation phase of the analytical process. Since the basic relationships of the trace element, flavonoid and carotenoid, and polysaccharide compositions with authenticity appear to be meaningful, we are testing and refining the models developed with additional samples and data. Upon completion of this study, we will have developed considerable knowledge of orange juice authenticity and intend to use this knowledge for the protection of the consumer and the legitimate citrus industry.

Other future prospects for the increased use of pattern recognition methods in food composition studies include:

- Monitoring of changes in food composition (including quality control) resulting from new processing technologies such as irradiation and genetic engineering, and from decomposition.
- Sensory evaluations and product development/formulation.
- **Salubrity (composition/biological activity studies).**

Automation and computer data handling of chemistry-based analytical systems, such as gas and liquid chromatographs with general and specialized detection systems and ancillary equipment such as headspace analyzers, offer an enormous variety of approaches to analytical data for the chemical characterization of food composition. Spectroscopic measurements such as near-infrared and NMR spectroscopy can also afford extremely valuable information on food composition—often of the intact food. The rapid development of computerized electrophoresis systems, with their increased qualitative and quantitative capabilities, will certainly have significant use in food protein analysis.

Table 3—KNN Classification of Fisher-weighted ICP[a] data in Phase 2

True class	Computed class 1	2	3
1	98%	1%	1%
2	0	100%	0
3	0	0	100%

Class	Description
1	Authentic
2	Adulterated
3	Pulpwash

[a] Inductively coupled plasma emission spectroscopy

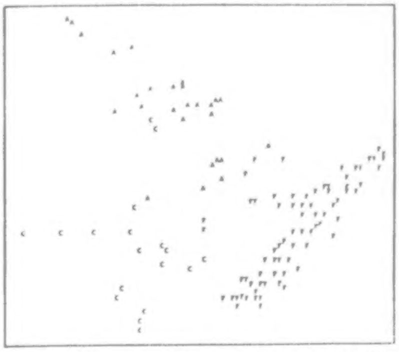

Fig. 3—Principal Component Projection *of Fisher-weighted ICP data from Phase 2, illustrating the excellent separation of authentic Florida (F) and California (C) orange juices from adulterated orange juice (A). ICP = inductively coupled plasma emission spectroscopy*

Multivariate analyses of analytical data such as pattern recognition are not the correct answer to all problems in the food composition universe. Their major criteria for success, as with any analytical process, are the design of the experiment and the careful measurement of the data. They are extremely powerful methods for studying complex physical and chemical data to determine the various causes and effects of food composition.

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Table 4—SIMCA Classification of scaled HPLC[a] data from Phase 3

True class	Computed class							
	1	2	3	4	5	6	7	8
1	100.0%							
2		100.0%						
3			82.4%			11.8%		5.9%
4				94.4%	5.6%			
5				6.7%	93.3%			
6				16.7%		83.3%		
7							100.0%	
8				18.2%				81.8%

Class	Variety	Location
1	Valencia	Florida
2	Valencia	Other U.S.
3	Valencia	Non-U.S.
4	Hamlin	All
5	Pineapple	All
6	Navel	All
7	Others	Florida
8	Others	Brazil

[a] High-performance liquid chromatography

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Based on a paper presented during the IFT Citrus Products Technology Group program, "Citrus Flavors—Advances in Production and Analysis," at the 46th Annual Meeting of the Institute of Food Technologists, Dallas, Tex., June 15-18, 1986.

The following FDA Center for Food Safety and Applied Nutrition staff have contributed to the orange juice adulteration project: R. Albert, G. Alvarez, F. Boland, T. Chambers, J.-Y. Chen, L. Dusold, F. Fry, F. Joe, E. Jones, J. Jones, P. Kassim, E. Mazzola, M. Mossoba, G. Perfetti, N. Rainey, J. Stack, P. Sosinski, and M. Sullivan.

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—Edited by Neil H. Mermelstein, Senior Associate Editor

QUESTIONS SUBMITTED BY SENATOR DOMENICI

Biennial Budget Cycle

QUESTION: Calls for budget reform are increasingly heard as budget deadlines are too often missed, important budget decisions are delayed, appropriation bills and other direct spending legislation are held up in committee, and omnibus spending bills take the place of timely and orderly consideration of individual bills. One procedural reform that is being considered is the two-year budget cycle where budget and appropriations matters would be considered in the first year, and authorizations and oversight would be undertaken in the second year. Would your department/agency favor a biennial budget process? What benefits would your agency achieve in a two-year appropriation cycle? Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission? What difficulties can you foresee in preparing and submitting a two-year budget to the Congress? Would you expect to realize any budget savings if you could plan your agency budget on a two-year basis? If so, could you estimate how much? If you oppose the biennial budget concept, please give this subcommittee your reasons why.

ANSWER: The Department of Health and Human Services definitely favors a biennial budget process. In fact, this year the Department proposed two-year appropriations for several accounts not related to FDA programs. Two-year appropriations would allow for improved fiscal management as well as for improved planning for the awarding of contracts and grants. Also, a two-year appropriation would eliminate at least some of the problems that have been encountered in the past when a new fiscal year starts and the agency must operate under one or more continuing resolutions before the appropriation for the year is known.

The majority of FDA's appropriation request is normally for funding to continue the current level of operations. For example, of FDA's total request for 1988 of $483.5 million in total obligational authority, $5.2 million is for specific program increases, with all of the rest to support the 1987 level of operations, including allowances for inflation and changes in salary and benefit costs. The agency already prepares outyear budget estimates for all accounts as part of the President's budget process. Therefore, it would not be particularly difficult to prepare an appropriation request for a two-year period, although requests for supplemental actions would still need to be submitted from time to time.

There might be some savings in terms of staffhours devoted to budget preparation and the appropriations hearing process and in the time devoted by senior management to the budget process. However, at the same time there would have to be very careful monitoring of funds since there would be more time elapsing since the appropriation request was prepared and more time for circumstances to change during the time the appropriation was in effect. Since the agency has operated for many years under single-year appropriations, it is difficult to estimate precisely any direct costs or savings that would result from a two-year cycle. However, there would definitely be qualitative benefits for agency management if the agency knew its basic funding level for a period of two years.

One difficulty with two-year budgeting in the current environment might be the overall Federal deficit in light of the Gramm-Rudman-Hollings deficit reduction targets. If deficits changed during the first year of a two-year cycle, it might be necessary to propose adjustments for the second year in the form of proposed supplemental appropriation actions or rescissions.

SUBCOMMITTEE RECESS

Senator BURDICK. This concludes our hearings with Agency witnesses for the fiscal year 1988 budget for Agriculture, Rural Development and Related Agencies.

Beginning Monday, April 6, at 3 p.m., in this same room, the subcommittee will hear congressional and public witnesses relating to the fiscal year 1988 appropriations for these areas.

Until then, the subcommittee stands in recess.

[Whereupon, at 11:20 a.m., Wednesday, April 1, the subcommittee was recessed, to reconvene at 2:30 p.m., Monday, April 6.]

MATERIAL SUBMITTED BY AGENCIES NOT APPEARING FOR FORMAL HEARINGS

[CLERK'S NOTE: The following agencies of the Department of Agriculture did not appear before the subcommittee this year. Chairman Burdick requested these agencies to submit testimony in support of their fiscal year 1988 budget request. Those statements follow:]

DEPARTMENT OF AGRICULTURE

OFFICE OF THE SECRETARY AND DEPARTMENTAL ADMINISTRATION

STATEMENT OF JOHN J. FRANKE, JR., ASSISTANT SECRETARY FOR ADMINISTRATION

Mr. Chairman and members of the Subcommittee, I am pleased to appear today to discuss with you the activities and fiscal year 1988 budget request for the Office of the Secretary, Departmental Administration, Advisory Committees, GSA Rental Payments and Building Operations, and the services provided to USDA agencies through the Department's Working Capital Fund.

This budget continues a process we began earlier, that is increasing our effectiveness, carefully re-examining our workloads, reassessing duties and procedures, and realigning duties and activities. Our management initiatives are paying dividends now. We have underway several activities or programs that benefit all agencies of the Department. Involved are:

- Development of a central Equal Employment Opportunity (EEO) counselling and dispute resolution program;
- Development of central "generic" training programs;
- Development of personnel records systems and information to meet USDA employees' needs under the new Federal Employees Retirement System (FERS)--an effort that involves both our personnel and finance offices;
- Continued cross-servicing of federal agencies primarily by the National Finance Center (NFC), and development of a government-wide system for management and operation of the FERS Thrift Plan;
- Assumption from GSA of building management at Fort Collins, Colorado and of several other USDA owned or leased buildings;
- Development and operation of an automated procurement system that greatly cuts down on contract document preparation and processing times;
- Consolidation of data centers to make them more effective.
- Increased oversight of EEO compliance and increased competition advocacy.

We will continue to expand ways to increase our productivity through good management practices and excellence in the workplace, so as to provide the best administrative support possible within our resource levels. We know we must. I would like now to review some of the specifics of the 1988 budget.

OFFICE OF THE SECRETARY

The appropriation for the Office of the Secretary provides funds for the Secretary, the Deputy Secretary, the Under and Assistant Secretaries and their supporting staffs. The fiscal year 1988 budget request totals $5,903,000, an increase of $637,000 above the current estimate for fiscal year 1987. The increase consists of $262,000 for retirement costs and pay costs. The remaining increase of $375,000 includes inflation as well as a general operating increase. These additional funds would establish a more realistic operating level commensurate with administering the functions and policies of a major Department. For the last several years we have been providing the Congress data showing that the cost of administering USDA is significantly below that of comparable Departments. Each year the gap widens. Now we must request additional funds to insure that no degradation occurs in the quality of management or evaluation of Agriculture programs.

We are again proposing a single account for the Office of the Secretary (OSEC). The ten separate accounts not only intensify administrative problems, but also restrict the flexibility of the Secretary to assign and redirect resources among the Offices as needed to carry out the Department's policies.

DEPARTMENTAL ADMINISTRATION

The fiscal year 1988 budget request for Departmental Administration is $40,239,000, an increase of $17,167,000 above the current estimate of $23,072,000 for fiscal year 1987. There are two major new activities included in this request. New requirements for hazardous waste clean-up and disposal were imposed upon our agencies when the Comprehensive Environmental Response, Conservation and Recovery Act, commonly know as the "Superfund Act," was enacted during the last session of the Congress. The Department has decided that its hazardous waste activities can be best managed through a central account from which resources will be allocated to agencies according to priority of need. For fiscal year 1988, $15,000,000 is requested to establish that central account.

Also included in the request is an increase of $110,000 for the National Communications System (NCS) to pay USDA's prorata share of the National Level Program of emergency communications as mandated by Presidential National Security Decision Directive 201. This payment supports development of the NCS. The remaining increase of $2,057,000 consists of $1,101,000 for retirement costs and $233,000 for pay costs. Not counting the two new activities or the retirement and pay cost increases, Mr. Chairman, the DA budget has increased $723,000, or 3.1 percent above the 1987 Current Estimate. The Staff Offices have repeatedly absorbed management reductions, met deficit reduction targets, and attempted to continue providing service and policy oversight to USDA's agencies. However, in the past, this has been possible through improved methods, productivity and efficiencies. In a period of declining resources, new work has been added to already overburdened staff groups to meet new initiatives that contribute to the Department's programs. For 1988, we are moving to apply resources to Personnel, Operations, Advocacy and Enterprise. Resources are also being applied to the Office of Budget and Program Analysis to ensure a continued high level of service in supporting the Department's programs.

ADVISORY COMMITTEES

USDA Advisory Committees other than those for the Forest Service are funded from a single appropriation originally established by the Congress in the Fiscal Year 1983 Appropriations Act. That initial appropriation was $1,398,000. The request for fiscal year 1988 is $1,308,000, which is the same as the fiscal year 1987 appropriation.

Advisory Committees provide USDA agencies with supplemental, specialized expertise from academia or the private sector on a broad range of issues. It would not be feasible to maintain these experts as permanent staff, so these Committees are a means to get essential services on an as needed basis.

RENTAL PAYMENTS AND BUILDING OPERATIONS

A consolidated appropriation finances a portion of the Department's payment to the General Services Administration for space and related costs. In fiscal year 1988, the Department has requested $56,407,000 for its space inventory. The fiscal year 1988 request is $8,652,000 over the current fiscal year 1987 appropriation and partially covers the cost of GSA rate increases and changes to the space inventory in selected geographic regions.

Departmental staff and support services to operate and maintain seven Agriculture buildings are funded through a separate appropriation for this purpose. For fiscal year 1988, the request is $21,669,000, an increase of $3,281,000 over the current fiscal year 1987 appropriation. The major portion of this increase, $3,245,000, is for the one-time acquisition of furniture systems. GSA's renovation of our Auditors Building uses the systems design concept as a integral part of the structural renovation. Use of furniture systems will permit consolidation of the Forest Service from leased space to Government-owned space and still provide a quality work environment. It will also reduce space utilization in the Building to 115 square feet per person. Both actions will result in significant savings to the Government. The remaining increase of $36,000 covers the additional retirement costs and pay costs.

WORKING CAPITAL FUND

Mr. Chairman, I need not point out to you and the other members of the Committee that the difficulties we face in financing our programs in USDA require us to continually seek innovative yet cost effective ways to provide quality administrative support and financial management services. For the past forty-three years, our Departmental Working Capital Fund has supported just those kind of services, allowing our program agencies to pursue their programmatic goals unencumbered by the details of providing such services separately and individually. More importantly, recent experience and our Fiscal Year 1988 initiatives will enable us to achieve even greater economies for the benefit of both our USDA agencies and other Government agencies making use of our services. I would like to turn to a brief description of these services and our plans for those activities.

Our largest WCF activity, in terms of annual budget and personnel, is the National Finance Center in New Orleans, Louisiana. The Center continues to serve as the Governmental standard in offering quality financial and administrative services. From both inside and outside USDA, user agencies are able to take advantage of such services as centralized financial management, accounting, administrative payments, personnel, property management, and recordkeeping. Such is the reputation for quality earned by the Center that it was selected to develop and initially operate the Thrift Savings Plan component of the new Federal Employee Retirement System after it was determined that no private source would be capable of implementing the quick start-up of the system the plan demanded.

In the area of automated data processing and telecommunications support, our Departmental Computer Centers in Fort Collins, Colorado; Kansas City, Missouri; and here in Washington; as well as our telephone service and local area network operations at Headquarters provide agencies with cost-effective and technologically superior mainframe computing and telecommunications services. In Fiscal Year 1986, we completed a productivity study of our computer centers which, if implemented, will allow us to improve services further, at greater savings.

Here in Washington, centralized support services are provided to agencies in supply management, mail distribution, duplicating services, video and film, design, imprest fund, property management, shipping and receiving, correspondence management, and numerous other administrative operations.

As you can see, the WCF supports quite a range of activities. This demands quality management control and oversight to insure effective service and financial integrity. That is why, in addition to the oversight you provide, we employ a two-part system to review the finances and services of the WCF. The first part of this system is the review conducted by the WCF Comptroller, who oversees the ongoing operations of the Fund. He and his staff conduct initial reviews of activity budget requests, review on a quarterly basis the finances and management accomplishments of WCF activities, and advises me in my role as "Chief Executive Officer" of the Fund. The second part involves an interagency review board comprised of seven agency program representatives and Departmental budget office representatives. This "board of directors", if you will, conducts further reviews of activity budget requests and quarterly reports on the status of WCF activities. The board then recommends to me and to the Comptroller actions which will further improve financial and activity management of the Fund. We view this input from the board as a vital element in effective management of the WCF. The agency perspective on WCF activities is essential.

acting much as a customer feedback program serves to improve private firms in the delivery of goods and services. As a result of this open, comprehensive review, we have prepared a budget which will allow us to continue providing superior services while exercising fiscal responsibility.

Despite our recent accomplishments and the reputation we have earned for the quality of our services, Mr. Chairman, we stand at an important crossroads in the management of centralized services and the WCF in particular. As you are aware, we have initiated service agreements with other Federal agencies over the past few years. For instance, the National Finance Center has entered into agreements with several diverse agencies, including the Department of Education, the Department of Commerce, and the Merit Systems Protection Board, to provide a range of services such as payroll/personnel, administrative payments, and central accounting. There is a two-way gain in this approach. The reimbursements we have received from those agencies have benefitted USDA agencies, by reducing the share of fixed costs they must bear, and the other Federal users have benefitted, by allowing them to avoid the up-front developmental costs they would have to expend to duplicate the services we provide. These agreements, part of a strategy we call "cross-servicing", result in a win-win outcome for all current and potential service clients. While this means that total activity costs and staff levels needed to do the work may increase, we achieve considerable savings within the entire community of service users, both in the price of services received - a cost saving - and in costs not paid in developing an agency's own resource - a cost avoidance. We are aware that in the past there have been comments regarding the rising costs of our WCF activities. We believe that this is a short-sighted view, failing to appreciate the obvious benefits when the wider view is taken. We strongly believe that it is this wider view that deserves attention. To focus solely on the apparent costs of a WCF activity, or the WCF as a whole, without an appreciation for the wider benefits they create, may force us, as managers of the Fund, to forego future agreements or terminate existing ones as we fulfill our basic responsibilities to our agencies in USDA. We believe this would create a lose-lose situation for USDA and other Federal agencies. Cross-servicing will significantly reduce unit costs of service to all users through economies of centralization as the potential benefits accrue to a much wider population than

USDA. In this vein, Mr. Chairman, I think it is important that all of us take a look, not only at the year-to-year changes in our estimates for staff and dollar levels, but how any marginal increases for the WCF are more than offset by savings in the development and operation of duplicative services elsewhere in Government - duplication we are seeking to avoid in this era of necessary budgetary management.

An important element in providing adequate resources is capital acquisitions support. As part of the ongoing plan USDA and Congress developed in 1984, we are requesting $6,000,000 for capital acquisitions in fiscal year 1988. We have had considerable success in modernizing our equipment inventory as a result of the funds provided by the Congress over the past three years. It is due in large part to the technological superiority of the assets purchased with these funds that we have been able to both increase the quantity of service we provide and still maintain our reputation for quality in the services we deliver. We expect that further quality improvements can be made with even greater cost effectiveness as a result of the acquisitions planned for 1988. This year, Mr. Chairman, we expect to achieve a net cost savings of $2.9 million over three years with purchases made from Fiscal Year 1988 funds, and a total lease cost avoidance over 1985-1988 of $15.2 million. We believe this justifies the confidence place in USDA at the beginning of 1984. This is evidence of the continued application of responsible management principles to to financing of WCF activities. We will work hard to evaluate our ongoing needs so that we increase benefits to users while minimizing costs.

Having said all this, we are proposing an operating level in Fiscal Year 1988 of $119,433,000. This excludes support for capital acquisitions. Non-inflationary increases in this figure are due primarily to needed increases for cross-servicing activities as we hold the line on costs to USDA agencies.

Mr. Chairman, this concludes my prepared statement. Detailed information is provided in the budget justifications we have furnished to you, but I would be glad to provide further details and respond to any questions you may have.

OFFICE OF GOVERNMENTAL AND PUBLIC AFFAIRS

STATEMENT OF WILMER D. MIZELL, ASSISTANT SECRETARY

Mr. Chairman and members of the Subcommittee, I am pleased to discuss the fiscal year 1988 request for the Office of Governmental and Public Affairs (OGPA).

I have with me today James Boillot, Deputy Assistant Secretary for Governmental and Public Affairs, John McClung, Director of the Office of Information, and La Verne Ausman, Director of the Office of Intergovernmental Affairs.

As you are aware, OGPA is the communication core of the Department of Agriculture. Although we are under tight budget restraints, the use of technology has allowed us to respond to an increasing inquiry load. Through advances in print technologies, electronic communications and satellite transmissions, we are able to communicate the Department's policy and program information to Congress, the public, and State and local governments.

Through organizational streamlining, OGPA has developed an efficient communications operation which enables us to communicate to a larger audience. OGPA has, in the past year, responded to an average of 1,200 calls per month from Congressional offices, and up to 2,000 calls per month from the public. Our Office of Information last fiscal year issued over 1,600 news releases, features and reports while over 1,500 news stories containing actualities were produced for radio and 431 for satellite TV news service transmission.

Our teleconferencing center conducted seven live video conferences last fiscal year, and for the first five months of fiscal year 1987 conducted 262 audio conferences. The audio conference use represented a 5-fold increase from the same time period of the previous year.

The Office of Public Liaison last fiscal year held numerous briefings at the Department which included several for constituents organized at the request of Members of Congress, and 92 groups representing various agricultural interests. This Office recently sponsored a highly successful "Secretary's Challenge Forum" on biotechnology.

FISCAL YEAR 1988 BUDGET REQUEST

I am requesting a funding level of $8,796,000. This represents a net increase of $397,000, or approximately 5 percent above our fiscal year 1987 level of $8,399,000. This increase consists of several items.

Specifically, we are requesting an increase of $52,000 to annualize 1987 pay costs, $296,000 to fund increased costs associated with the Federal Employees Retirement System, and a $49,000 increase in general operating expenses.

We will continue to publish the *Yearbook of Agriculture* for distribution as in prior years.

This concludes my statement, Mr. Chairman. I will be happy to respond to any questions.

OFFICE OF THE GENERAL COUNSEL

STATEMENT OF CHRISTOPHER HICKS, GENERAL COUNSEL

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to appear this morning to discuss with you the appropriation request for the Office of the General Counsel of the United States Department of Agriculture for fiscal year 1988.

FUNCTION AND ORGANIZATION

The Office of the General Counsel serves as legal counsel for the Secretary of Agriculture and provides all legal services for the programs, operations and activities of the Department of Agriculture. These services include:

-- rendering legal opinions;

-- preparing or reviewing rules and regulations;

-- drafting and reviewing proposed legislation;

-- preparing or interpreting contracts, mortgages, leases, deeds and other documents;

-- preparing briefs and representing the Department in judicial proceedings and litigation;

-- representing departmental agencies in non-litigation debt collection programs;

-- processing applications for patents for inventions by the Department's employees;

-- representing departmental agencies in state water rights adjudications;

-- considering and determining claims by and against the United States arising out of the Department's activities;

- representing the Department in formal and informal administrative proceedings;
- assisting the Department of Justice (DOJ) in the preparation and trial of cases involving the Department;
- representing the Secretary of Agriculture and the Commodity Credit Corporation before the Interstate Commerce Commission, the Federal Maritime Commission, and the International Trade Commission;
- providing legal advice on EEO, personnel, freedom of information and privacy act matters.

Our work is performed in Washington, D.C., and in 22 field offices across the country. The six offices established in 1983 as a pilot project under reimbursement from the Farmers Home Administration are now a permanent part of our field structure. Presently, 51 percent of our authorized personnel are located in the field.

FY 1988 BUDGET REQUEST

We have requested $19,903,000 in direct appropriations for fiscal year 1988. This request represents an increase of $2,158,000 over the fiscal year 1987 level of funds available. Approximately one-half of the requested increase is to pay for the increased pay and retirement costs ($989,000) that became effective last month, and for non-salary inflationary increases ($66,000). The remaining increase consists of $1,103,000 for 23 additional staff years.

The request would allow the office to fully fund 385 staff years for the first time in several years. Three hundred and eighty-five has been the authorized level since

1984 and, after careful analysis again this year, represents what is considered to be the minimum staffing level necessary to meet the Department's legal needs.

Upon my appointment last June, I was surprised to learn that, although our staff year ceiling was 385, our budget -- even before Gramm-Rudman -- was inadequate to fund that level. With the Gramm-Rudman reduction last year, our affordable staff years dropped to 347 or 38 below the minimum level needed to do our job. Discretionary expenses were reduced or cut out altogether. We had no training budget, no awards budget, no equipment budget, and reduced travel, supplies and book budgets.

Discretionary expenses, however, account for only about six percent of our budget. Eighty eight percent of our budget is for personnel costs. Accordingly, any significant reduction in funding must result in a reduction in the major resource of the Office of the General Counsel -- its people. During the last fiscal year, sixty-four employees, 26 attorneys and 38 support staff, left the Office of the General Counsel. Because of the budget restrictions, however, we could replace only 25 of those 64 employees.

With the appropriation increase in fiscal year 1987 and the proposed supplemental for increased pay and retirement costs we plan to hire 16 additional employees, and we are now in the process of recruiting. We have also been able to allocate small budgets for training and awards and have increased the amounts available for travel and supplies.

Nevertheless, despite this progress, I must admit that we are currently barely able to maintain the level of services that the Department requires. Faced with an exploding workload, it is questionable whether we will be able to maintain current services for the remainder of fiscal year 1987 and beyond.

GROWING WORKLOAD

New legislation, increased litigation, increased or redirected program activities and policy changes have intensified our client agencies' demand for legal services even more than was predicted a few years ago. This is not going to change in the foreseeable future.

The Food Security Act of 1985 provided for a number of new or expanded programs to increase U.S. agricultural commodity exports. These include the financing of sales of agricultural commodities for foreign currencies which are then loaned for the expansion, promotion and improvement of food production in the foreign country; donation or financing of sales of agricultural commodities to developing countries that promote free enterprise in their agricultural sectors; targeted export assistance and export enhancement programs; sales and donations of red meat and sales of dairy products. While the changes require many new or revised regulations, announcements, contracts, claims and litigation, the number of attorneys available to handle this work has decreased by 20 percent during the last fiscal year.

Pursuant to the National Forest Management Act of 1976, the Forest Service has issued 56 Land Management Plans that have already resulted in 306 administrative appeals. It is expected that the 67 plans to be completed this year will represent the most highly contested plans -- those in the Pacific Northwest -- increasing the number of appeals by approximately 400.

Although the case load has increased substantially under the Federal Tort Claims Act, there is no staff to devote to administrative review of claims. Attorneys are reduced to addressing these serious Federal liability cases only where lawsuits are filed. In addition, the five attorney staff devoted to USDA procurement contracts Department-wide has been reduced by half. The five attorney appellate litigation staff is operating at 60 percent of its required strength.

Increased emphasis on program accountability in the Department's domestic food assistance programs will result in further increases in associated legal services. Currently, there is extensive litigation arising out of quality control sanctions against some states for their handling of the Food Stamp Program in fiscal years 1981 and 1982. Significant additional legal workload is related to sanctions against states announced for fiscal years 1984, 1985 and 1986 and anticipated in 1987 and 1988. Staff available to provide legal services for these purposes is presently at only 66 percent of the required level.

In addition, new programs, new legislation and amendments to existing statutes have increased work requirements in several other areas, such as the Animal Damage Control program, the meat products inspection program, regulation of biotechnology, grain quality improvement, the Clear Title Act, and the many changes associated with the Food Security Act of 1985.

At the end of fiscal year 1979, when our staff year ceiling was 343, we were responsible for over 10,300 cases. By the end of fiscal year 1984, with 385 staff years, the caseload had grown to 38,300. Currently, with an on-board strength of about 335, we have 40,400 cases. The Farmers

Home Administration is expected to refer approximately 24,000 additional cases to this office in the coming months, increasing our caseload to 64,400.

Of course, whatever our budget and staffing situation happens to be, we must and will continue to provide essential legal services, such as defense of lawsuits filed against the United States. Without additional staffing, however, some non-mandatory work may have to be terminated.

USE OF FY 1988 BUDGET

The $19.9 million that we are requesting will support 385 staff years which, as I said before, has been our authorized ceiling since 1984. This level will not put us ahead, but it would allow us to begin to make a dent in our heavy case backlog.

The 23 additional staff years funded by the requested $1,103,000 will be divided between headquarters and the field. Present plans are to put 17 in the field offices and six in Washington, D.C.

The remaining two aspects of our requested increase, funding for annualized pay and retirement increases and increased operating costs, require no special explanation.

In closing, Mr. Chairman, I want to say that I am fully aware that requesting a budget increase -- even an increase as small as this request is in the context of the total budget of the Department of Agriculture -- is not something to be lightly contemplated in these times of fiscal restraint. After careful consideration, however, I believe that the budget request for fiscal year 1988 is one that is necessary to allow the Office of the General Counsel to provide quality legal services and to discharge our responsibility as the legal arm of the Department.

We appreciate the support that you and the Committee have provided to our office in the past. That concludes my statement. I'll be happy to answer any questions the Committee may have.

OFFICE OF THE INSPECTOR GENERAL

STATEMENT OF ROBERT W. BEULEY, INSPECTOR GENERAL

Mr. Chairman, Members of the Committee, I appreciate the opportunity to appear before you today to discuss the activities of the Office of Inspector General (OIG) and discuss some of the major areas in the Department where we are placing emphasis.

GENERAL COMMENTS

OIG will celebrate its silver anniversary this year. In 1962 with the assistance of some members of this Committee, the IG concept was first established in USDA. That year OIG identified $8.8 million in monetary results. In 1986 we identified $142 million; $30 million resulting from our investigative efforts and $112 million from our audit efforts.

As our monetary results indicate, we continue to have success with Departmental agencies in obtaining management commitments to collect funds paid in error and to redirect funds for more efficient use. We believe with this good record, OIG more than pays for itself.

Since my appointment as Inspector General in August 1986, I have been reviewing the activities and accomplishments of the agency and, overall I believe OIG is a strong, effective audit and investigative organization. My staff and I expect to concentrate our efforts on fine-tuning our ongoing operations that have produced effective results in the past.

For example, to better direct our investigative program and to help obtain the highest return on the investment of our resources, we have implemented a formal annual investigative planning process. The plan addresses the major issues of preventing and detecting fraud and abuse in the programs and operations of the Department. My investigative priorities continue to be: (1) threats to the health and safety of the public, (2) allegations of employee corruption, theft or embezzlement, or collusion with program participants, and (3) fraud in the Department's loan and benefit programs.

In the audit area we have developed a more formalized strategic planning process to better ensure that our resources are directed toward those Department programs and activities which are highly vulnerable to misuse and of the highest priority to the Secretary and the Congress. We have identified several strategic areas where we intend to focus our audit resources during FY 1987 and the next few years.

The most significant of these are continuation of our efforts discussed at last year's hearing to review new initiatives and changes resulting from enactment of the Food Security Act of 1985 -- particularly the Dairy Herd Termination; Conservation Reserve; Production Adjustment and Export Incentive provisions. We have also identified loan portfolio management, focusing on the Farmers Home Administration (FmHA) interest rate reduction and the guaranteed loan programs; inventory management of Commodity Credit Corporation-owned commodities and FmHA acquired farm and home property; and supervision of entitlement programs as significant audit program areas.

LOAN CONVERSION AND PAYMENT LIMITATIONS

In addition to the above, in the areas of FmHA and Agricultural Stabilization and Conservation Service (ASCS) we have continued our commitment to the investigation of cases which involve the conversion of mortgaged chattel pledged to both FmHA and ASCS for loans and other program assistance. Also, in ASCS we have increased our efforts to identify, through audit and investigations, abuse of program payment limitations by groups or persons claiming to be eligible as separate "persons".

HEALTH AND SAFETY

We have continued to place a high priority on Food Safety and Inspection Service, Animal and Plant Health Inspection Service, and other Department programs affecting the health and safety of the public and the Department's employees. We have conducted 8 investigations involving violations of the Anti-Tampering Act affecting food products regulated by the Department. Our efforts in this area have resulted in the arrest and conviction of an individual who was responsible for tampering with food products in the plant in which he was employed. In another case the investigation focused on the alleged victim who, when confronted by the evidence, confessed that the incident was created by him to obtain recognition and money.

EMPLOYEE MISCONDUCT

The integrity of the Department's programs and the employees who administer and regulate them is a priority of OIG. Based on our prior investigative results, it appears that the Department does not have a serious problem with employee misconduct considering the number of employees (over 100,000). In FY 1986 there were 167 cases, with 31 indictments. However, I agree with the position of other Departmental managers that one case of employee misconduct is one too many. To emphasize the importance of employee intregity, we recently issued a handbook entitled "How to Keep Out of Trouble" developed by the President's Council on Integrity and Efficiency (PCIE). The handbook provides a summary of the ethical standards and conduct required of Federal employees and was endorsed by Secretary Lyng for issuance to all USDA employees.

FOOD AND NUTRITION PROGRAMS (FNS)

We are continuing our efforts to detect and prevent fraud in the Food Stamp (FS) and Women, Infants and Children (WIC) Programs. Also, in the past year, we have continued to conduct investigations of FS trafficking. For example, we recently conducted a series of investigations that resulted in 25 people being charged for violating the Food Stamp Program. These people received in excess of $17,000 in food coupons for cash, firearms, narcotics, tires, beer, and pornographic material. In the WIC program our investigative efforts have uncovered a scheme to deposit illegally obtained and redeemed WIC vouchers. In this case $2.3 million in WIC vouchers were submitted in claims for reimbursement.

SINGLE AUDIT ACT

The Single Audit Act of 1984 established uniform, organization-wide financial and compliance audit requirements for State and local governments receiving Federal financial assistance. Under the Act agencies are assigned cognizance by the Office of Management and Budget. When we have cognizance, we work very closely with independent auditors to provide quality control reviews of the work from beginning of the audit throughout the actual audit effort to ensure that the appropriate audit standards are met.

FY 1986 OIG MONETARY RESULTS AND BUDGET REQUEST

During FY 1986 OIG issued 1,046 audit and 1,312 investigative reports. As a result of our investigations, 507 indictments and 402 convictions were obtained, 22 suits were filed and 149 fines were levied. Recoveries, collections, restitution, fines, claims actually established and costs not incurred totaled $30.3 million. Audits resolved during FY 1986 resulted in management commitments to seek recoveries of an additional $54.8 million and management commitments to more efficiently use funds for an additional $57.2 million. In FY 1986 OIG continued to expend our resources on the programs with the largest dollars that are most susceptible to fraud, waste and misuse. The big three agencies of FmHA, ASCS, and FNS accounted for nearly 65 percent of our resources.

FY 1988 BUDGET REQUEST

The FY 1988 budget request for the Office of Inspector General is $50.4 million. Although this is a small increase from our FY 1987 level, the increase is only to provide funds to restore the agency to our 1986 staffing level; and to provide funds to offset mandated changes in travel relocation allowances, annualization of the agency's cost of the new Federal Employees Retirement Service and the three percent Government pay raise effective in January, and increased inflationary operating costs.

This concludes my statement Mr. Chairman. I would be glad to respond to questions from the Committee.

NATIONAL AGRICULTURAL LIBRARY

STATEMENT OF JOSEPH H. HOWARD, DIRECTOR

Mr. Chairman and members of the Subcommittee. I welcome this opportunity to appear before you to discuss the proposed fiscal year 1988 budget for the National Agricultural Library (NAL). I would like to introduce Mr. Sam Waters, the Associate Director.

The National Agricultural Library serves as the apex of a system of libraries throughout the nation, unequalled any where else in the world, which provides information on agriculture.

State university land-grant libraries, with NAL as the hub, cooperate in this effort. In recent years, the NAL has worked at strengthening this collaboration. Some of these initiatives are:

- Cooperative cataloging. Land-grant libraries help in cataloging State Experiment Station and Extension Publications as well as other agricultural titles into NAL's AGRICOLA bibliographic database.
- Improved interlibrary lending and borrowing. The NAL now processes the majority of the requests for loans within 24 hours.
- A new Aquaculture Library Network. Libraries from institutions designated by Congress as regional aquaculture centers are the initial members of a newly established library network.
- A proposed National Agricultural Text Ditigitizing Project. While funding is not yet in place, 40 of the libraries have pledged $120,000 toward the project. If proven feasible, this process could provide access to masses of material that would otherwise be unavailable.
- Phase II of the full-text storage and retrieval laserdisc project. Originally launched in 1984, the first phase of this project focused on evaluating the potential of videodisc used in conjunction with microcomputers to store and disseminate information. The second phase, joined by 15 land-grant university libraries, takes a closer look at the conversion and mastering process, using 12 different U.S. Department of Agriculture and State Cooperative Extension Service publications on a second disk.
- AGRICOLearn, an interactive course instruction in the online searching of the AGRICOLA database. A course is being developed with the

University of Maryland which will be on computer floppy disc, with motion videos, graphics or animation and sound available on a laser videodisc. Land-grant institutions will be asked to test and evaluate the final product.

Interaction and cooperation with other Federal agencies increased markedly. The NAL and the National Library of Medicine (NLM) reached an agreement concerning the collection and servicing of human nutrition materials. The purpose of this project is to ensure broader coverage and prompt processing of relevant human nutrition information while minimizing costly duplication of effort. The libraries will ensure that materials will be collected at the comprehensive level, processed promptly, made widely available for ready use, and preserved indefinitely for future needs.

Significant special collections of materials on remote sensing, food irradiation, animal welfare, and Agent Orange were transferred to the NAL from other Federal agencies. Other major donations included materials on poultry from the American Poultry Historical Society, and a special collection belonging to the late Charles Valentine Riley, pioneer scientist and entomologist, which was placed on permanent exhibit in the Library's new Special Collections Reading Room.

Expanded coverage of forestry materials in the NAL/AGRICOLA database are to be provided under an interagency agreement with the Forest Service (FS). The FS will fund at least three additional positions at the Library to do the primary work and will also station other FS personnel here to reduce overlap and consolidate processing of materials. In another cooperative project, the USDA's Food Safety and Inspection Service (FSIS) began working with NAL to develop a database on safety, nutrition, and other aspects of food irradiation.

As the result of a continuing agreement with the Environmental Protection Agency (EPA), the NAL has produced 13 commodity-oriented bibliographies useful in the regulation of pesticides, as well as for research in the field of plant or commodity protection.

Library services were extended and strengthened in 1986. Four specialized information centers concentrating on subjects of current agricultural concern--alternative farming systems, animal welfare, fiber and textiles, and family--were established to provide selective, in-depth access to world-wide literature on a given topic, and offer other related information services. This brought to 10 the number of such centers in operation at NAL. Most importantly, these centers allow the library to assume a proactive rather than a reactive role in responding to user needs.

In a related move, the NAL began exploring the development of computer-based systems, that will help users obtain answers to questions on agricultural topics. Since such systems mimic the advisory work done by human experts--in this case, reference librarians--the first such NAL system was produced by and for the librarians who operate NAL`s Aquaculture Information Center. Other such systems will be tailored to the needs of librarians and users at the other specialized information centers at NAL.

An integrated library system incorporating the latest computer technology will be installed at the National Agricultural Library during the next 2 years. The system will be used to manage the Library's 1.9 million volume collection, eliminating current fragmented, multiple computer operations and resulting in significant savings in time and money and greater access to the collection.

A scholar-in-residence program was established at the NAL with the objective of attracting distinguished researchers in agriculture to make in-depth use of its preeminent collections. A prominent historian of U.S. agriculture and a specialist in aquaculture and marine science were appointed as the first participants in this program. The Library also signed a cooperative agreement with the University of Maryland's Department of History establishing a fellowship program in ornamental horticulture at the university. The program, funded through a gift donation to NAL, will focus on the historical development of marketing research and information services for the ornamental horticulture industry.

Following the 1985 conversion of the Washington, D.C. Branch Library into a reference center, the 250,000 volumes on agricultural economics/statistics formerly housed there were moved last year to the main library at Beltsville. To make space, the remainder of the total NAL collection was shifted and some space was converted to compact shelving.

A new software demonstration center was established at the Library in recognition of the growing importance of computer technology in American agriculture. The Center's program was designed to provide the increasing number of microcomputer users with the opportunity to evaluate agriculture-related software products.

Two open houses were held in the spring and fall featuring exhibits and briefings on the specialized information centers, demonstrations of new technologies, and explanation of other user services. Some 500 people attended from the USDA and other Federal agencies, trade associations and other private sector organizations, and area libraries.

The NAL introduced its official logo, the first since the Library was founded in 1862. The new logo is a bold and dramatic representation of the NAL in the information age. It will serve as the Library's trademark signifying dynamic leadership in the collection and dissemination of agricultural information.

A policy of charging for extended information and research services was announced effective January 1, 1987. Under this policy, most categories of users--with the exception of USDA personnel--will be billed for information support services in excess of a threshold level. The new fee program will allow a broader spectrum of users to utilize reference-research services than was previously possible. In the past--largely due to budgetary constraints--comprehensive in-depth reference assistance was reserved for USDA personnel and other selected audiences.

In sum, the National Agricultural Library (NAL) significantly advanced its outreach efforts in 1986 by expanding its network of formal agreements and working arrangements with a broad spectrum of public and private sector institutions. Areas of mutual concern inlcuded collection development processing, new technologies, and database building. The Library continued to seek greater efficiency and cost effectiveness in its public and technical service operations by adopting advanced computer-based systems, reorganizing and consolidating its collection, and by establishing user fees for reference services.

We propose for FY 1988 a budget of $12,356,000, which includes a program increase of $894,000 for collection development and preservation. Part of the increase will be used to offset the devaluation of the dollar in purchasing foreign publications. Also, new technologies have compelled NAL to broaden its coverage of non-print media to include the collection of audiovisuals, machine-readable data files, software, compact discs, and other expensive new publishing media. The balance of the increase will be used to investigate new technologies which offer more permanent and economical solutions to preserving materials and information, in addition to continuing a binding program.

My colleagues and I will be happy to answer any questions that you might have.

WORLD AGRICULTURAL OUTLOOK BOARD

STATEMENT OF JAMES R. DONALD, CHAIRPERSON

Mr. Chairman and Members of the Committee, it is my pleasure to appear before you today to discuss the fiscal year 1988 budget request of the World Agricultural Outlook Board.

Overview

The World Agricultural Outlook Board (WAOB) plays a critical role in the U.S. Department of Agriculture's (USDA's) ongoing effort to ensure that its commodity information system responds to today's rapidly changing world agricultural sectors. The purpose of the WAOB is twofold: to provide the most accurate, objective, and timely economic intelligence on worldwide developments which influence U.S. agriculture; and to speed the flow of that information to producers, consumers, policymakers and the general public.

WAOB's main function is to coordinate and review for accuracy and consistency all USDA estimates and analyses relating to international and domestic commodity supply and demand conditions. WAOB maintains liaison with international organizations, such as the United Nations' Food and Agriculture Organization, and domestic agencies, such as the Commodity Futures Trading Commission.

WAOB is the Department's focal point for weather and climate information and weather-based impact assessment; these monitoring activities within USDA are coordinated by the WAOB Chairperson. Remote sensing activities in USDA also are coordinated by the WAOB Chairperson. Space sensors and ground-based sensors which communicate through space relay systems have the potential to improve the accuracy and timeliness of earth resources data and crop condition information now collected on the ground.

Specific Functions and Progress

WAOB has continued to improve its ability to integrate information from the Department's world agricultural intelligence system. WAOB chairs the Interagency Commodity Estimates Committees (ICEC's) and seeks to expand each ICEC's analytical role in current condition and impact assessment. These committees include representatives of the Economic Research Service (ERS), Agricultural Stabilization and Conservation Service (ASCS), Foreign Agricultural Service (FAS), Agricultural Marketing Service (AMS), and WAOB. All committee members are USDA professionals with responsibility for developing official estimates of supply, utilization, and prices for the major agricultural commodities. It is through the interagency membership of these committees that the various USDA agencies work together in a coordinated effort. Development and use of new analytical tools and evaluation of forecasting performance has become an ongoing responsibility of each committee.

Weather, as much as any economic or policy development, continues to be a significant and most unpredictable variable underlying agricultural production and prices. Consequently, USDA places a high priority on incorporating weather-based assessment information into all analyses. The focal point is the Joint Agricultural Weather Facility (JAWF), operated jointly by the Board and the National Oceanic and Atmospheric Administration (NOAA). This facility, located in the South Agriculture Building, continually monitors and assesses global weather events and their probable impact on agricultural output. JAWF briefings, reports and special alerts are key inputs to ICEC and Board deliberations.

The Weekly Weather and Crop Bulletin and electronic networks are the principal means used by JAWF to disseminate meteorological assessments to the public. JAWF's early warning capability diminishes the likelihood that farmers and other participants in the agricultural system would be caught off guard by a foreign crop failure or some other significant global weather-related event.

The World Agricultural Supply and Demand Estimates report (WASDE) is the only report published by WAOB. Beginning in 1985 the timing of the WASDE report was modified to provide for its release on the same day as U.S. crop reports. Formerly global trade, utilization and stocks estimates were released on the day following the World Crop Production report. By combining major elements of both reports, WAOB responded to the preference of users to receive maximum commodity information on a timely basis while minimizing potential repeated market reactions caused by frequent release of sensitive information throughout the month. The Foreign Agricultural Service now publishes an expanded World Crop Production report one day following release of the WASDE report.

While striving to enhance analytical capability, WAOB recognizes that the demand for rapid information dissemination will continue to expand. Increasingly, improved technologies are being used to speed the flow of information. The principal objective is to place the World Agricultural Supply and Demand Estimates report into the hands of farmers and other users as quickly and effectively as possible. WASDE is now transmitted electronically upon release at 3 p.m. to a central USDA system that can forward it to all interested users, greatly broadening the potential for report dissemination. Also, the report summary is now being sent electronically to our embassies and trade offices around the world to keep U.S. agricultural attaches, counselors, and trade representatives current with the very latest information on U.S. supplies and prices.

The Agricultural Statistics Board (ASB) of the National Agricultural Statistics Service and the WAOB continue to co-locate in a single lockup facility to maximize security conditions for compilation and analyses of world crop data and supply/demand estimates. This physical arrangement with the ASB facilitates interaction between domestic and international analysts and eliminates the movement of highly sensitive data between two separate lockup areas.

Recent Activities

The WAOB added forecast reliability tables to the WASDE report. These tables provide users with a measure of the accuracy of the monthly domestic and foreign supply and demand estimates for grains, soybeans and cotton. Monthly estimates of production, exports, domestic consumption and ending stocks are compared to the final estimates. Measures of relative accuracy and bias are shown for each parameter for the most recent 5-year period.

The WAOB coordinated USDA's monitoring and analysis of two events which had major agricultural significance during the past year, i.e., the drought in the southeastern United States and the nuclear accident at Chernobyl, USSR. The severity and potential for sensationalism which characterized both events demanded that they be analyzed with special care and objectivity. USDA's analysis of both events, while produced under extreme time pressure, have proven to be quite accurate.

A "state-of-the-art" global satellite weather imagery processing system was installed in the Joint Agricultural Weather Facility. This system was purchased jointly by the Departments of Commerce (NOAA) and USDA. The system captures and stores weather satellite images from four satellite systems — GOES (U.S.), METSAT (U.S.), METEOSAT (Europe), GMS (Japan). Installation of this system has significantly improved JAWF's analytical capability.

The WAOB served as the focal point for extensive consultation within USDA, including the Office of the General Counsel (OGC) as well as program agencies, regarding procurement of satellite data from the private sector and the protection of the data in accordance with provisions of the Trade Secrets Act. As a result, sound data procurement procedures were institutionalized and unnecessary and duplicative purchases of satellite data were precluded.

The WAOB planned, organized and directed USDA's 1986 Agricultural Outlook Conference, December 3-5, 1986. Under WAOB's direction, an interagency program committee selected program topics and speakers for sessions focusing on the general economy, farm economics, agricultural commodities, and special topics. The final program included 24 sessions and 85 participants. The program and speakers were well received by the 850 registrants.

Budget Request

Our total budget request for fiscal year 1988 is $1,802,000. This represents an increase of $143,000 above the fiscal year 1987 level of $1,659,000. This increase consists of $12,000 for annualization of the pay increase effective in fiscal year 1987, $59,000 for increased costs associated with the Federal Employees Retirement System, and $72,000 to fund support of integrated economic/meteorological forecasting systems. This support will enable the WAOB to derive maximum benefits from its extensive meteorological data base and place special emphasis on improving crop forecasts in Europe and the Soviet Union. In addition, this funding would provide computer support needed to minimize the potential for failure during lockup and assure timely release of the market-sensitive World Agricultural Supply and Demand Estimates report.

This concludes my statement, Mr. Chairman. My associates and I are prepared to answer any questions you may have concerning the WAOB programs and budget request.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

BIENNIAL BUDGET CYCLE

Question: Would WAOB favor a biennial budget process? What benefits would your agency achieve in a two-year appropriation cycle?

Answer: The WAOB would be supportive of a two-year budget cycle only if net staff-year savings would result. While less staff years would be spent for developing, documenting and presenting the annual budget request, these savings could be offset by additional costs associated with a two-year budget cycle for developing, documenting and presenting budget supplementals, amendments, and reprogramming actions.

Question: Approximately what proportion of your annual appropriation request would you consider simply repetitious of the previous year's submission?

Answer: Approximately 80 to 90 percent could possibly be considered repetitious.

Question: What difficulties can you foresee in preparing and submitting a two-year budget to the Congress?

Answer: The most difficult problem would be the accuracy of developing realistic budget estimates two years in advance. Projecting budget requirements too far into the future would not be as realistic as the one year budget, particularly during periods of extraordinary inflation with increasing operating costs and changing program priorities.

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